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PROVISIONS AIMED AT STRENGTHENING THE COMMUNITY REINVESTMENT ACT

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

COMMUNITY REINVESTMENT, CHECK CASHING, LIFELINE BANKING SERVICES, BRANCH CLOSINGS, CONSUMER PROVISIONS IN TITLE IV OF H.R. 5094, TO STRENGTHEN THE COMPETITIVENESS AND PROTECT THE SAFETY AND SOUNDNESS OF DEPOSITORY INSTITUTIONS

SEPTEMBER 8 AND 9, 1988

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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PROVISIONS AIMED AT STRENGTHENING THE COMMUNITY REINVESTMENT ACT

THURSDAY, SEPTEMBER 8, 1988

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:15 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Sasser, Graham, Wirth, Garn, Heinz, Bond, and Chafee.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we begin 2 days of hearings on various consumer provisions in the bill recently reported by the House Banking Committee. While our committee is familiar with the issues in general form, we have not considered some of the ambitious and novel provisions in the House bill.

In anticipation of a meeting with our House colleagues later this month, I believe it's important that members of our committee become more familiar with the House provisions.

For starters, there is the issue of basic banking services. Beyond the measures we considered, the House committee would require banks to offer both low-cost Government check-cashing services as well as a basic banking account. The goals are laudable, and I am anxious to hear how feasible the proposals would be.

The second general area involves provisions aimed at strengthening the Community Reinvestment Act. I happen to be the author of this law, and I take a special interest in it. CRA is, and should be, a tool to combat redlining and to encourage lending into poor neighborhoods within the boundaries of safe banking practices.

At the time of passage in 1977, CRA was meant to guide the Government's chartering practices. Where banks competed for a charter in a particular service area, the winner would be the one with a better record, a better record for meeting local credit needs, including low- and moderate-income neighborhoods.

I am pleased that in the 10 years since passage, CRA has steered some $6 billion of new credit to low- and moderate-income communities. Community groups have lauded the success.

From the beginning, however, I have been leery of credit allocation schemes run by the Federal Government. Some skeptics in

1977 worried that my bill would lead to Government-imposed credit allocation. I assured them then—and I quote what I said:

> This was not a credit allocation plan, and I certainly don't see it that way. Whatever we can do to prevent it from being a credit allocation bill I want to do.

Now, to be sure, improvements can be made in CRA, as we learned from hearings held last March, 10 years after CRA became law. Regulatory enforcement of existing law has deteriorated in recent years. It was not of prime concern to the regulatory agencies.

As a result, under the Reagan administration, examiner time dwindled and ratings were inflated. Almost everyone gets a passing grade, both the banks that work hard at community reinvestment and those that don't.

Already, we have begun to bolster CRA. The March hearings themselves may have strengthened enforcement. Perhaps most important, the Congress has made the Home Mortgage Disclosure Act permanent. Gail Cincotta, the godmother of CRA, realized the importance of that victory when she told the committee last March that HMDA is the centerpiece of making CRA work.

This morning we are privileged to hear first from a panel of regulators whose job it will be to implement the proposals. They have studied and you have studied them carefully, and I know that you have some concerns.

We will also hear from industry groups who will give us their views on these various provisions.

Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

First of all, Senator Chafee and Senator Heinz were here earlier and had to leave. I would ask unanimous consent that the statement by Senator Heinz be placed in the record.

The CHAIRMAN. Without objection, so ordered.

STATEMENT OF THE HONORABLE JOHN HEINZ
BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SEPTEMBER 8, 1988

MR. CHAIRMAN, I JOIN YOU IN WELCOMING OUR DISTINGUISHED WITNESSES AS THIS COMMITTEE EXAMINES AMENDMENTS TO THE COMMUNITY REINVESTMENT ACT AND OTHER CONSUMER-RELATED PROVISIONS PROPOSED RECENTLY BY THE HOUSE BANKING COMMITTEE IN H.R. 5094.

LAST MARCH, THIS COMMITTEE INVITED COMMUNITY GROUPS TO EVALUATE THE PERFORMANCE OF THE FEDERAL BANKING AGENCIES' ENFORCEMENT OF THE COMMUNITY REINVESTMENT ACT (THE "CRA"). THESE GROUPS WERE TOUGH GRADERS. EACH OF THE BANK REGULATORS WERE GIVEN FAILING GRADES.

THE COMMUNITY GROUPS ALSO COMPLAINED THAT THE BANK REGULATORS WERE EASY GRADERS WHEN IT CAME TO TESTING THE BANKING INDUSTRY'S COMPLIANCE WITH THE CRA. THESE GROUPS NOTED THAT 98% OF ALL BANKS RECEIVE PASSING GRADES WHEN, IN FACT, THE PERFORMANCE OF MANY BANKS SIMPLY DID NOT MEASURE UP.

SCHOOL IS NOW BACK IN SESSION. THE SCHOOL SUPERVISORS ON THE HOUSE BANKING COMMITTEE HAVE PROPOSED A BRAND NEW CURRICULUM, WITH LOTS OF REMEDIAL COURSES, A TOUGHER GRADING SYSTEM AND MANDATORY EXAMINATIONS EVERY TWO YEARS. MOST IMPORTANTLY, UNDER THESE NEW RULES, THE BANKS WILL NOT BE PERMITTED TO ENGAGE IN EXTRA-CURRICULAR ACTIVITIES, SUCH AS STARTING A SECURITIES BUSINESS, UNLESS THEY GET BETTER THAN AVERAGE GRADES ON THEIR CRA EXAMS.

THE BANKING INDUSTRY SAYS THAT THE NEW CURRICULUM IS TOO TOUGH. THEY DON'T MIND HAVING TO PASS A CRA EXAM, BUT FEEL THAT THE GRADING CURVE IS TOO HIGH. THEY SAY THAT NOT EVERY STUDENT CAN BE AT THE HEAD OF THE CLASS. IF THEY WORK HARD AND PASS THE CRA EXAM, THEY WANT TO BE ABLE TO ENJOY THE OTHER ACTIVITIES AVAILABLE UNDER GLASS-STEAGALL REFORM.

THE BANKS ALSO WANT TO DO AWAY WITH THE "POP-QUIZ" SYSTEM. THEY SAY THAT IF THEY PASS THE CRA EXAM, THAT IT IS UNFAIR TO BE RE-GRADED EVERY TIME THEY APPLY TO ENGAGE IN AN EXTRA-CURRICULAR ACTIVITY. GOOD GRADES, IN THEIR VIEW, SHOULD BE REWARDED WITH THE FREEDOM TO DO OTHER THINGS WITHOUT CHALLENGE, UNTIL THE NEXT EXAM.

MR. CHAIRMAN, THE GOALS OF THE CRA, ENACTED TEN YEARS AGO, REMAIN IMPORTANT TODAY. NO DOUBT, THE CURRICULUM SHOULD BE RE-EXAMINED AND, IF WARRANTED, UPDATED TO REFLECT CHANGES OVER THE PAST THE DECADE.

HOWEVER, AS WE EXAMINE THE HOUSE PROPOSAL, WE SHOULD BEAR IN MIND THAT CRA IS NOT THE ONLY COURSE IN OUR SCHOOL SYSTEM. WE WANT OUR FINANCIAL INSTITUTIONS TO BE WELL-ROUNDED, RESPONSIBLE, AND OF COURSE, HEALTHY AND PRODUCTIVE MEMBERS OF THE FINANCIAL SERVICE COMMUNITY. THE NEW EXTRA-CURRICULAR ACTIVITIES AVAILABLE TO BANKS ARE IMPORTANT TO THEIR DEVELOPMENT. THESE ACTIVITIES SHOULD NOT BE PUT OUT OF THE REACH OF THOSE BANKS THAT ADEQUATELY MEET THEIR CRA RESPONSIBILITIES.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Mr. Chairman, as you mentioned, today the committee starts 2 days of hearings on the consumer provisions of the banking bill passed by the House Banking Committee.

Mr. Chairman, while there are many other provisions of that bill that I think are substantial steps forward, I will not mince words: The consumer provisions, particularly the CRA sections, are an outrageous intrusion of the Federal Government into the credit allocation process. We might as well just require our financial institutions to lend to designated individuals without regard to their ability to repay. That was never the intention of the Community Reinvestment Act, as you mentioned, and it should not be now.

I will not stand idly by while Congress tries to turn banks and thrifts into public utilities. This is exactly the direction that this legislation would take us.

Besides this fundamental objection, there are many other problems with the CRA provisions. The ratings system appears to require that many banks flunk the CRA ratings, no matter how good their performance, because ratings are based on performance relative to other banks as opposed to some fixed standard. That sounds very much like the old bell curve to me. It is plainly unfair.

Likewise the rating and examination process would impose a totally unnecessary regulatory burden on financial institutions and their regulators, costing many millions of dollars. That is a waste.

Other sections of the consumer provisions also trouble me. The Lifeline banking account is a catchy name, but do we really need the Federal Government requiring banks and thrifts to offer basic accounts? It seems to me that many banks already have in place some kind of basic banking service available to consumers.

Furthermore, banks do provide basic banking services whether or not as a result of legislation. It is completely unnecessary to mandate Government check-cashing as well. The whole purpose of basic banking is to make it easy for anyone to open and use a bank account. Why isn't that enough? Why should we also require Government check-cashing on top of it? If we go that far, maybe we ought to require that banks pay people to use their service just to make sure that enough people are interested.

Before we rush out with new burdensome regulation, I think it would be a much better idea to take a close look at the experience of several States that already have effective State pilot programs in the area of check-cashing and Lifeline accounts. Maybe we could learn something useful from those experiences.

Finally, there has been some talk about moving a separate consumer bill at the end of this session if the larger banking legislation stalls. The suggestion is that such a bill might contain some of the provisions we are discussing today, where it might just include such provisions like home equity or truth-in-savings that have already passed this committee.

Let me serve notice right now that I will vigorously oppose any effort to do this. Senator Proxmire and I have sought for a long time to pass meaningful, comprehensive legislation, and we still have a chance to do that. Some consumer provisions are part of that effort and are already included in the Senate banking bill.

They should only be passed as a part of a larger package in which all important banking issues are addressed.

So, let me repeat, there is not going to be a bill that is separate. I have had a bellyful of the House of Representatives now for 14 years—14 years of the Senate acting responsibly to try to improve the banking community and financial services and comprehensive banking bills. But I am not going to go through the whole litany.

But if the Congress or the House thinks that they can stall year after year after year and be the cause of substantial problems like they were with the thrift industry—and still continue to be because of their stalling of recapitalization of FSLIC—and think they can stall all this year when Senator Proxmire's bill passed months ago with only two negative votes in the Senate, and then think they can separate it out at the end of a session and pass just their consumer provisions, oh, boy, a cold day in hell is a lot more likely than that, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn.

The Senator from Florida?

Senator **Graham**. No statement, Mr. Chairman.

The **Chairman**. The Senator from Missouri?

OPENING STATEMENT OF SENATOR BOND

Senator **Bond**. Thank you, Mr. Chairman.

I have read with a great deal of interest some of the testimony to be presented to us today.

I was particularly gratified to note in that testimony statements that the Community Reinvestment Act has had a positive impact, that there has been significant progress in home mortgage lending in low- and moderate-income areas, better attention to small-business lending, to small-farm lending. And I think these are significant steps that have come about through the CRA.

In addition, I was most interested to see that there had been a number of recommendations made by the gentlemen before us on how CRA might be improved. For my part, I would appreciate having recommendations on specific legislation or amendments that you feel would better carry out the work of the CRA while maintaining the safety and soundness of the system. I think that point is one which we will hear a great deal about today. We are interested in seeing that the system be improved, but I believe today we will be hearing a number of questions raised about the overall viability of the system if unwise or overreaching proposals are put forward.

So, I will look forward to hearing the testimony, and I will also welcome positive suggestions on how this legislation might be improved so we can better achieve the objectives that you, Mr. Chairman, set out upon initial introduction, which you also reiterated today.

Thank you.

The **Chairman**. Thank you, Senator Bond.

The Senator from Colorado?

OPENING STATEMENT OF SENATOR WIRTH

Senator **Wirth**. Thank you, Mr. Chairman.

I want to thank you for having this hearing. I think it begins in a positive way to set us up for the potential of a constructive conference with the Senate and the passage of the legislation that I think all of us want to see happen.

Two issues are in front of us, it seems to me, here. One is CRA and how tightly that is going to be enforced. And the second is check-cashing.

On the first, I think we look back to 1977. There was enormous opposition, I remember, from the banking community in general to the CRA. It passed, and now we are talking about whether we can make that a little more effective. That is one issue, and I don't see why we can't work that out.

Second, the check-cashing issue, this is not a new one to the committee. We had a hearing on this a couple of months ago on Senator Metzenbaum's legislation on this. I was struck by the fact that there were representatives of a few of the banks that came in very constructively, if you remember, saying that we ought to be able to work this out as well.

Opposed to them were the banking associations who came in saying that any kind of check-cashing provisions were the worst thing in the world, which didn't seem to be very constructive, but at the time when there are millions of people who do not have access to financial institutions in any way, shape, or form.

It seems to me we might take a leaf out of the constructive side of it, not the negative side that came from the ABA and others, but some of the constructive suggestions that were made and again be prepared for going to conference with some of those very good ideas that came out of some of the more constructive bankers.

So, I think we can work both of these out, and I hope that we are going to be able to get to conference. Again, I applaud you for setting up this situation so that we are prepared to go into conference and move rapidly, and I hope that that same sense of moving expeditiously is found with Congressman St Germain, a much-admired friend of Senator Garn.

Thank you very much, Mr. Chairman.

The CHAIRMAN. The Senator from Tennessee?

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you, Mr. Chairman.

I wanted to commend you for calling these hearings this morning, Mr. Chairman, on the consumer provisions of the bill that has recently been approved by the House Banking Committee.

Certainly, there is much in this consumer title that is worthy of enactment. But I think at the same time we have to approach all of this legislation dealing with the financial community, from the point of view of safety and soundness. The continuing devastating deterioration of FSLIC is all that we need to remind us, I think, of the fragility of the financial system and the damage that can result from, among other things, ill-considered legislation.

Now, the argument that is before us today, for these consumer provisions, is that we are giving the banks new and more profitable powers, so therefore we can require new services from the banks that could be potentially costly.

Well, I am not persuaded that new powers in and of themselves does mean more profits for banks. In fact, it can in the long run mean more risk, and greater losses, as we saw with the legislation dealing with the thrift industry.

So, I think, Mr. Chairman, we need to be cautious. There is much merit to most of these consumer provisions, but we have other problems to consider. So, I commend you for calling these hearings, and I look forward to the testimony that they will elicit.

The CHAIRMAN. Thank you, Senator Sasser.

Don Riegle, who is a very valuable member of the committee, couldn't be here because his wife is in the hospital. He is deeply interested in this legislation. So, I am going to take 2 minutes to read his statement because I think it is very important.

Senator Riegle says:

OPENING STATEMENT OF SENATOR RIEGLE

Mr. RIEGLE. These hearings are not only important because of their use in preparing us for a conference with the House, but also because community reinvestment is of keen interest to me.

Recently, the Detroit Free Press published a series of articles alleging serious credit discrimination on the part of major Detroit institutions. We have already written the regulators asking for a thorough investigation of these charges, and we have begun to collect our own information directly from the banking and community groups. More information is needed from the regulators on these allegations.

Equal credit opportunity and community reinvestment are not only goals we all support, they are the law of the land. The unhappy fact is, however, they remain goals, not a reality. We have seen a number of studies alleging persistent redlining in Atlanta; Washington, DC; Portland, OR, and now the allegations focus on Detroit.

According to the Free Press story, commercial lending is tight, with many funds coming from out-of-State banks. The Free Press concluded banks, I quote, "can do more." Lenders make three times as many loans to white neighborhoods as to black communities, and the gap has grown steadily since 1982. Even poor white areas receive more home loans than corresponding black areas.

While banks must be careful to make safe loans, there are thousands of worthy borrowers in Detroit who are not being served, according to the Free Press.

Our bankers are sensitive to that, and I am confident we will see greater lending. As we learned in our hearings last March, our key problem is with the regulators. Important laws are going unenforced. Those hearings revealed a 74-percent decline in examiner time during the first year of the decade as compared with the last year of the 1970's.

The fact is that community reinvestment failure rarely is disciplined. Of the 40,000 applications our committee surveyed during the last 10 years, a mere 8—8—out of 40,000 were rejected on Community Reinvestment Act grounds.

The regulators have achieved the questionable result of giving virtually all banks an above-average rating.

This committee has approved good laws: the Equal Credit Opportunity Act, the Community Reinvestment Act, and the Home Mortgage Disclosure Act, which supplement our civil rights laws. It is time we enforced them and made any necessary improvements.

Now, gentlemen, we are looking forward to hearing from you, and we will start left to right with the Comptroller of the Currency, the Honorable Robert Clarke.

Go ahead, Mr. Clarke.

STATEMENT OF ROBERT L. CLARKE, COMPTROLLER, COMPTROLLER OF THE CURRENCY, WASHINGTON, DC

Mr. Clarke. Thank you. Mr. Chairman, and members of the committee, the Office of the Comptroller of the Currency is committed to ensuring that national banks comply with the requirements of Federal law and regulation, including the requirements of the Community Reinvestment Act.

During the 2½ years since I became Comptroller of the Currency, we have restructured our supervisory operations to achieve greater efficiency and effectiveness in our supervisory process. We revised our supervisory approach to encourage national banks to do the right things and to do them right.

BANKS PERFORMANCE IS THE RESPONSIBILITY OF MANAGEMENT

Our approach—for both safety and soundness and compliance supervision—is built around the principle that a bank's performance is—first and foremost—the responsibility of its management. We can best supervise national banks by insisting that their managements put in place effective compliance policies, that they establish accountability, and that they develop systems and controls to monitor performance. We insist that national bank management take those actions, and we insist that the policies are followed and that the systems and controls in fact work.

Our revised compliance program has been in place for only 18 months, but our increased attention to compliance matters has already captured the attention of the industry. As bankers continue to focus on our efforts and respond to them, a much higher level of compliance will result—if our program is given the opportunity to work, and if we are not forced to replace the reforms which we have made before the results of those reforms can be fully measured.

We are committed to this revised approach. Anyone who doubts our commitment to it—or our commitment to compliance supervision generally—should take a few moments to read remarks that I made in early June at a legal conference entitled "New Initiatives in Banking Legislation: 1988." I would ask, Mr. Chairman, for permission for those remarks to be included in the record.

The Chairman. Without objection, they will be.

[Remarks of Robert L. Clarke follow:]

Mr. CLARKE. Mr. Chairman, I am here this morning to discuss title IV of H.R. 5094, which is part of the banking reform legislation that the House Banking Committee approved in July.

CONCERNS ABOUT ENACTMENT OF TITLE IV

The OCC has five serious concerns about title IV of that bill. Our concerns lead us to the conclusion that it would be unwise and unwarranted to enact title IV. What are our five concerns? The legislation's consequences; its inflexibility; its costs; its effects on supervision; and its effects on Glass-Steagall Act reform. Now, let's look at each of those concerns in turn.

CONSEQUENCES

First, its consequences. It is no secret that when it comes to CRA, the Congress is under pressure from two extremes: first, from consumer groups who want everything and, second, from financial institutions who want only the minimum. The job of Congress—and a difficult job it is—is to find the right balance between those two extremes—not by splitting the difference, but by using judgment to weigh one extreme against the other, always in light of the public interest, which in the case of any banking legislation is the safety and soundness of the banking system.

The approach to CRA now embedded in Federal law and regulation is the result of Congress endeavoring to strike the right balance within the context of safety and soundness. Unfortunately, the assessment and enforcement approach to CRA in title IV, we believe, would replace this balancing of concerns with the mandate—indirect though it may be—that banks simply channel lending toward specific markets.

In other words, the legislation would likely have the effect of changing the objective of the Community Reinvestment Act from one of balancing community credit needs with safety and soundness concerns to one of allocating credit. This change would likely result from the combined effects of a system that would: (1) rank banks on a relative basis, (2) apply a "community benefits" test for acquisitions and expanded business lines, and (3) require the publication of information on CRA assessments.

Quite simply, title IV would set quantitative goals. It would likely result in quotas on certain types of loan activities. This approach is ill-conceived from the standpoint of public policy because it would relegate safety and soundness considerations to a secondary role.

INFLEXIBILITY

The OCC's second concern with title IV is that it would prescribe in unprecedented—and unwarranted—detail how the Federal bank regulatory agencies must enforce consumer laws.

COSTS

Our third concern is that it would impose a costly and inefficient system of administering those laws. The legislation's provisions dismiss concerns about cost and efficiency by attempting to shift the burden of collecting compliance data to the bank supervisors. That dismissal ignores reality. Whether the banks collect the data or the supervisors do, the banks will wind up paying for it. If the OCC does the data collection work as title IV envisions, we will charge the banks for the extra time we spend through increased assessments.

As for efficiency, only the banks can provide the data necessary to evaluate their performance. Why approach it by going the long way around? Clearly, it would be more efficient for the banks to provide the data for examiners to review than it would be for examiners to have to ask the banks for it. But either way, the banks will bear the burden.

Furthermore, in one important sense, the banks, their supervisors, and the public will bear a significant indirect cost if the provisions in question are enacted. As a practical matter, the regulatory agencies, which are 100 percent funded by industry assessments, will have to absorb some of the immediate costs of the proposed agency changes: the costs of diverting management resources to the reorganization of the agencies, of using existing examiner resources to initiate staffing, and of implementing the new policies. The diversion of resources from our safety and soundness responsibilities would occur at a time when a record number of banks have failed and when we have a large number of problem banks still requiring extra supervision. Ultimately, then, title IV would impose the cost of a more risky banking system on the public at large, an unintended outcome that would clearly be inconsistent with the intentions of the House Banking Committee.

EFFECTS ON SUPERVISION

Our fourth concern is that in calling for increased disclosure, title IV would subject examiners to undesirable pressures—a concern which I have discussed in detail in my written statement.

And, as great as those four concerns are, our fifth and final concern is even greater. The most troubling part of this bill is the linkage it would forge between Glass-Steagall reform and CRA performance.

EFFECTS ON GLASS-STEAGALL REFORM

When you introduced financial reform legislation in November of last year, Mr. Chairman, you characterized the Glass-Steagall Act's restrictions on competition between investment banks and commercial banks as "a protectionist dinosaur" and "a fossil held over from a bygone era" and concluded that "[t]he American economy and the American people deserve better." Amen. Under your leadership, this committee, and subsequently the Senate, approved S. 1886, which would provide the basis for the modernization of the Nation's financial services industry. It would permit needed competition between commercial and investment banks.

The survival of every bank will not be assured by Glass-Steagall reform, but the survival of our banking system as a competitor in the financial services marketplace may very well depend on it. Mr. Chairman, the repeal of the Glass-Steagall Act is of such importance that our attention should not be diverted from that goal. We cannot afford to delay Glass-Steagall reform, particularly to solve unrelated—although important—problems.

By creating a more competitive financial services industry—by creating a stronger and more vigorous banking system—S. 1886 is truly proconsumer with respect to its securities provisions. Its insurance provisions, Mr. Chairman, are another matter, and, as I have said before, they are anticonsumer, discriminatory, and clearly bad public policy. I hope this committee sees fit to strike them before the legislation is finally enacted.

But that being said, I think we would all agree that Glass-Steagall reform—as embodied in S. 1886—is needed urgently. And I think we would all agree that community credit needs are important as well. But we should ask ourselves the question: Must CRA goals be tied to Glass-Steagall reform to be achieved? No. They can be achieved separately. We believe that in linking CRA goals with Glass-Steagall reform, the Congress would deprive the American consumer of the full benefits that expanded business activities for banks would bring. My written statement discusses in detail why this would be the case.

Title IV of H.R. 5094 is ill-conceived, and I cannot support the provisions that make it so. The only good thing I can say about title IV is that we can still choose whether it will become law or whether it does not. In my judgment, it should not.

Thank you very much.

[The complete prepared statement of Robert L. Clarke follows:]

Remarks by
ROBERT L. CLARKE
Comptroller of the Currency

before the Conference:
"New Initiatives in Banking Regulation: 1988"

Washington, D.C.
June 6, 1988

Whenever you approach anything in a new and different way, critics ten to judge your efforts by the experience of the past. In doing so, the often miss the point of your efforts. And, as a result, they misinterpret what you do as being mere fad or fashion.

Thirty-two years ago today, New York Times critic Jack Gould made such mistake. The evening before, Elvis Presley had appeared on nationwide television. The Times critic wrote of Presley's performance: "Mr. Presley has no discernible singing ability. His specialty is rhythm songs, which he renders in an undistinguished whine . . . For the ear is an unutterable bore."

Let me ask you two simple questions:

How many of you have ever heard of Elvis Presley?

How many of you have ever heard of Jack Gould?

Now I'm no student of fine art theory, and probably most of Presley's devoted following weren't such scholars, either. Presley wasn't interested in an audience that appreciated Proust, Picasso, and Paderewski. He was interested in an audience that would appreciate rhythm and blues, rock and roll, and Presley.

He played by different rules. And in the process he redefined what American popular music was to be, which was his goal, and one he successfully met.

There is a lesson for any critic in Jack Gould's review of Presley's n approach. It seems to me that any critic who judges in haste should b prepared, if not to repent, then at least to reassess, at leisure.

Sixteen months ago the OCC undertook a new approach to compliance supervision, an approach with two complementary objectives. The first objective was to spend more time on compliance supervision. The second was to strike the right balance between compliance supervision and safety and soundness supervision, our principal mission.

To meet these two objectives, we developed a compliance supervision program which focuses on the process by which compliance with law and regulation is to be achieved. This process encourages banks to adopt systems to ensure that all their activities are conducted in compliance with law. It establishes clearly that bank officers have both the responsibility and the accountability for a bank's compliance efforts. And it emphasizes to senior bank management that it is their responsibility to ensure that bank systems are working -- every day -- whether or not we are in the bank.

For the OCC, focusing on the process has meant taking a set of complementary actions designed both to promote compliance and to monitor the performance of national banks.

These actions have included:

-- Improving education efforts -- telling banks what we expect of them.

-- Simplifying the compliance process.

-- And developing off-site evaluation capacities that would assist examiners in detecting noncompliance through the use of sophisticated statistical and computer analysis.

Our objective is to improve compliance through these efforts, but if we don't achieve the results we desire, we can also deter noncompliance through appropriate corrective action.

In terms of technique, our revised compliance program is a departure from the way we did things in the past. As you know, throughout most of its history, the OCC relied almost exclusively on regularly scheduled examinations to meet our responsibility to promote safety and soundness AND to promote and monitor bank compliance with the law. In the compliance area, we used these regularly scheduled examinations to identify any areas of noncompliance, and when we found them we would recommend appropriate remedies to bank management.

One might call this the "stick" approach to compliance. We would find faults and force bankers to fix them.

Unfortunately, that approach to compliance, or any other part of supervision, had one major drawback: it dealt with problems directly only after the fact.

While our revised approach will still find faults and force bankers to fix them, as I stressed before, its principal purpose in promoting compliance is to encourage bankers to create systems to avoid faults in the first place. In other words, in addition to promoting compliance through imposing remedies where noncompliance is found, the OCC's approach elevates compliance as a managerial function just like the other managerial functions we look for in a bank. And by taking a systems approach to monitoring compliance ourselves, we believe that our revised compliance program will allow us to track noncompliance more effectively.

Most importantly, we believe it will lead to a higher level of compliance in the industry.

Because our approach is different now from what it was in the past, to judge it by past experience would be a mistake. Unfortunately, one of the misconceptions I have observed concerning our compliance program is that some people believe it is a temporary solution to our problem of scarce resources and large numbers of problem banks. Another misconception is that we are only tipping our hat to our compliance responsibility -- in other words, a lick and a promise. Neither is the case.

Rather, our revised approach to compliance supervision is a recognition that traditional bank supervision techniques increasingly failed to provide the best means of fulfilling our supervisory responsibilities.

After 16 months of testing and development of the revised approach, I can draw two conclusions about our new methodology: it meets our objectives and it is here to stay.

It has often been said that our mission as supervisors is to change behavior, and the first step in changing behavior is to show that change is reasonable. My personal experience with the revised compliance program indicates that it is already beginning to achieve that goal.

As I travel around the country, bankers -- the target of our supervisory efforts -- tell me that our revised program makes a lot of sense to them.

As we had hoped, it is increasing awareness among bankers of the responsibility they have for compliance and the importance we place on it.

And bankers are responding by making efforts we intended to promote: creating compliance systems that clearly delineate internal accountability for operating a bank's activities in compliance with law.

For example, the senior management of a major midwestern bank holding company last year implemented a corporation-wide comprehensive compliance management system -- which identifies violations and prompts their correction -- a system that embodies the objectives of our revised approach. The management developed a corporate policy statement that describes the bank's compliance system, outlines responsibilities, and communicates the support of senior management and the Board of Directors. The bank's program includes a Compliance Committee, which represents the lead bank and the holding company. Daily compliance activities are administered by a Compliance Section, which is housed in the bank's legal division and is staffed by four full-time officers. In addition, compliance officers have been designated for each area or location throughout the holding company. The compliance officers are responsible for implementing new laws, training, responding to audits and correcting violations. The company has also developed a comprehensive Compliance Manual to serve as an overall compliance guide, and it supplements this manual with departmental procedural manuals. The Compliance Manual has been distributed to all departments and company locations. The company's Audit Department performs compliance reviews, which are also being conducted by the Compliance Review Officer. The company maintains a log of violations to identify problem areas and trends. And the company has developed a calendar of compliance training. Over 1987, more than 1,400 officers of the holding company attended various training sessions under its compliance effort. Finally, and of significant importance, the company publishes a compliance newsletter to maintain compliance awareness among its officers and employees.

Actions speak louder than words -- and the management of this major banking company is telling all concerned that it is committed to compliance and eager to provide the leadership and direction necessary to make its compliance effort a success.

If senior management at all national banks were to evidence that level of commitment, that type of willingness to provide leadership and direction, their efforts would enhance the overall level of compliance by national banks far more than our imposing after-the-fact remedies to ensure compliance could ever hope to do. Fostering commitment, leadership and direction on the part of senior management is, therefore, the ultimate objective of our program.

At the same time, however, we are aware that this ultimate objective is both long-term and ideal. So one of the five components of our revised approach continues to be to deter noncompliance.

As you know, under our revised approach to compliance supervision, we do not examine every bank every year.

How do we ensure that banks we do not visit are complying with the law?

First we assume that most banks want to comply and that our help in telling them what our expectations are -- and assisting them in developing compliance techniques -- will result in an overall higher level of compliance, regardless of enforcement efforts.

But, we also rely on a classic strategy of deterrence that incorporates three elements. First, individuals or firms that are subject to law or regulation must believe there is a reasonable chance they will be monitored for compliance.

This is how the Securities and Exchange Commission operates.

This is how the Internal Revenue Service operates.

This is how the Highway Patrol operates.

Generally, it works.

Even so, under our revised approach, there is more than a reasonable chance -- there is a reasonable expectation -- that an individual national bank will be examined for compliance.

Each year we conduct examinations in one half of all regional and multinational holding companies -- and their affiliates as appropriate -- and in a random sample of all other banks that are not in the largest holding companies. This random sample, on average, includes 16 percent of all banks under $1 billion in assets. Furthermore, this sample for examination is large enough so that analysis of information from the banks that are examined can provide statistically valid conclusions about all the banks in the national banking system -- an important point that I will return to in a moment.

Second, for our strategy of deterrence to work there should be a very high chance that any noncompliance will be detected. One measure of that element at work is the fact that, over the last year, resources devoted to compliance examinations have increased dramatically.

The third, and final, element in our compliance strategy is that the individual bank must believe that we will require appropriate corrective action when we detect noncompliance.

Why should it believe that?

Because we do require -- and we will continue to require -- such corrective action.

For example, several months ago we signed a formal agreement with an $11 million bank in the midwest that laid out the steps we insisted this bank take to clean up its compliance act.

Our monitoring of the bank turned up no financial problems there.

In terms of financial condition, this bank was -- and is -- among the highest rated banks in its region and size categories.

Because of the bank's sterling financial condition, it would have been unlikely that we would have performed an on-site examination there routinely at the time we did.

However, the institution was chosen as one of the banks in the random sample to be examined for compliance this year -- and when we examined it we found its compliance performance considerably flawed.

Our examination found that the bank's management had taken no steps to create a formal compliance system at the institution. It had no written standards for credit decisions on consumer installment, home improvement or home purchase loan applications. The bank had no formal training program for compliance. And management evidenced no interest in taking any steps to improve its compliance performance by creating a compliance system. The management simply could not understand the need for doing so, even when our examination found a large number of consumer law and regulation violations:

The examination found substantive violations of Equal Credit Opportunity Act regulations and Truth-in-Lending Act regulations that evidenced a pattern or practice of violations in the institution, as well as violations of the Community Reinvestment Act and various other housing related rules.

The management's response to those violations was: "We will get better forms."

Our response was quick -- and direct.

In short, we told them: "You will create a compliance system."

Under our agreement with this $11 million institution, the bank developed and implemented a written compliance program within 45 days.

That program included:
-- The naming of a compliance officer;
-- A written description of the duties and responsibilities of the compliance officer;
-- The preparation of a policies and procedures manual covering consumer protection for use by appropriate bank personnel in the performance of their duties and responsibilities;
-- An audit program to test for compliance,
-- Procedures to ensure that exceptions noted in the audit reports are corrected,
-- The education and training of all appropriate bank personnel in the requirements of all federal and state consumer protection laws, rules and regulations; and
-- Periodic reporting of the results of the compliance audit to the Board of Directors.

A moment ago I mentioned that we are analyzing the information collected from the sample of banks we are examining. We hope to identify common compliance problems -- and the characteristics of banks likely to have those problems -- in conducting that analysis.

One benefit of statistical analysis is that it may help in identifying components of regulations with which compliance seems particularly difficult.

The information itself comes from a compliance data sheet that our examiners complete during each examination.

During the last three quarters, we have conducted examinations of hundred national banks, and some of the information we have collec far is quite interesting, even though at this point we cannot draw statistically valid conclusions for the system as a whole from it.

We've found that in 95 percent of the cases where the banks' own s of controls revealed Bank Secrecy Act violations, the banks routin corrected the violation. The banks routinely corrected consumer violations when they were revealed by their own systems about 90 p of the time. And 93 percent of the time violations of trust laws regulation revealed through the banks' own systems of internal and external controls were routinely corrected by the banks.

But the news isn't all good.

In many of the banks we examined we found Bank Secrecy Act, consum trust violations -- technical and substantive -- that were not det the controls of the bank.

In other words, in the vast majority of cases where a system found problem it triggered a correct response -- the bank corrected the before we got there.

But much of the time either there wasn't a system or the system di find a problem when the problem existed.

Of course, many of these problems were technical and were, therefo less concern to us than substantive violations would be.

Nevertheless, while the preliminary results from our survey show c that the system approach to compliance is valid, there is room for improvement in the performance of the systems of control that bank have.

Where do we go from here?

Just as we expect the banks we supervise to improve the performanc their systems of control, we are working to improve the effectiven the efficiency of our revised compliance approach.

We are currently field-testing changes in our compliance examinati procedures.

As soon as we have the latest quarter results from the compliance sheets that our examiners prepare, we will begin our statistical a of the pool of information that we have collected over the year.

This analysis, in turn, will allow us to further refine our approa

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And, finally, we intend to have an OCC Compliance Manual completed around the beginning of 1989.

I would like to leave you today with this one thought: last year I bought three pairs of glasses. Was I interested in glasses? No. I was interested in seeing.

Just as glasses are a means to an end, so, too, are supervisory techniques. In judging them, the only standard that matters is how well they work in accomplishing the supervisor's mission.

Our supervisory mission is to raise the level of bank compliance with law and regulation. Our old compliance approach allowed us to remedy the violations we found present in banks. Our new compliance approach accomplishes the same end, but we believe it adds greater incentives for bankers to prevent violations from happening in the first place. It is clear to me that this approach offers the better corrective -- and preventative -- prescription.

Thank you.

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APPENDIX

Assessment Factors & Examination Procedures

COMMUNITY REINVESTMENT ACT

TWELVE ASSESSMENT FACTORS	EXAMINATION PROCEDURES
1) Bank activities that ascertain the credit needs of its local community.	Obtain information from a review of bank records and interviews with bank staff. (Studies/customers/neighborhood groups/local government)
2) The extent of the bank's marketing and special credit-related programs to make community members aware of credit services available.	Review bank's marketing program. (RE brokers/mtg counseling programs/advertising/convenient hours/brochures)
3) The extent of participation by the bank's board of directors in formulating CRA policies and in the bank's CRA performance.	Review minutes of board of directors meetings and any other bank documentation available. (Bank staff awareness of CRA)
4) Any practices intended to discourage applications for credit listed in the bank's CRA statement.	Review other fair lending examination programs (ECOA and Fair Housing Act). (Bank staff awareness of CRA/prescreening)
5) The geographic distribution of the bank's credit extensions, credit applications and credit denials.	Initially rely on discussion with other examiners, review of examination reports and working papers of other programs. Review bank files and interview bank management. Additional reliance may be placed on geocoding.
6) Evidence of discriminatory or other illegal credit practices.	Review prior reports of examination and other examination programs currently being performed.
7) The bank's record of opening and closing offices and providing services at offices.	Obtain information from the field or district office or from the bank's records. Review any public comments.
8) Bank participation in local community development and redevelopment projects or programs.	Review written lending policy and procedure manuals. Interview lending officers. (HUD's community development block grant program/local neighborhood preservation efforts/CDCs/neighborhood housing services)
9) The bank's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated within its community.	Review bank financial statements, HMDA disclosures, lending policy and procedure manuals. Interview bank staff.
10) Bank participation in governmentally insured, guaranteed, or subsidized loan programs for housing, small businesses or small farms.	Review bank financial statements, HMDA disclosures, lending policy and procedure manuals. Interview bank staff. (FHA/VA/FmHA mortgage loans/SBA loans/FHA Title I home improvement loans)
11) The bank's ability to meet community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors.	Review examination workpapers and reports. Consider safety and soundness. (Small banks may lack resources)
12) Other factors that bear upon the extent to which a national bank is helping to meet the credit needs of its entire community.	Consider factors such as bank purchases of state and municipal bonds, secondary mortgage market securities or whether the bank's policies promote efforts to assist existing residents in neighborhoods undergoing reinvestment and change.

For release on:
September 8, 1988; 10:00 a.m.

STATEMENT OF
ROBERT L. CLARKE
Before the
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
September 8, 1988

INTRODUCTION

Mr. Chairman and members of the Committee, I am here this morning to discuss Title IV of H.R. 5094, part of the banking reform legislation that the Committee on Banking, Finance, and Urban Affairs of the House of Representatives approved in July. The OCC has serious concerns about this portion of the bill, and we think it would be unwise and unwarranted to pass its provisions. The most troubling part of this bill is the linkage between Glass-Steagall reform and the Community Reinvestment Act (CRA). Among other things, it is likely to have the effect of changing the purpose of CRA from a law that seeks to balance community credit needs and safety and soundness concerns to one that attempts to allocate credit. It would also prescribe in unprecedented detail how bank regulatory agencies would enforce consumer laws, imposing a costly and inefficient system of administering those laws.

When you introduced financial reform legislation in November of last year, Mr. Chairman, you characterized the Glass-Steagall Act's restrictions on competition between investment banks and commercial banks as "... a protectionist dinosaur" and "[a] fossil held over from a bygone era" and concluded that "[t]he American economy and the American people deserve better." Under your leadership, this Committee, and subsequently the Senate, approved S. 1886, which would provide the basis for the modernization of the nation's financial services industry. It would permit needed competition between commercial and investment banks, and would likely result in an improvement in the selection, availability, and quality of financial products, including those products produced by the competitors of commercial banks. Moreover, it would provide, with administrative simplicity and directness, adequate protection to insulate bank deposits from most risks that may be associated with new activities.

Although Glass-Steagall repeal will not be a panacea for the banking industry's problems, we can ill-afford to delay this reform, particularly to pursue unrelated, albeit important, goals. As I testified before this Committee in May, even though earnings of national banks stabilized in 1987, declining profitability has been a persistent phenomenon during the 1980s. The return on assets for the median national bank was .79 percent in 1987, compared to the most recent peak of 1.11 percent in 1980. Permitting banks to compete in those markets from which they are now prohibited would create new income opportunities for banks and expand their opportunities for diversification. The survival of all banks will not be assured by Glass-Steagall repeal, but the successful competitors in the new market would make a stronger banking industry. The longer we wait to achieve Glass-Steagall repeal, the harder it will be for banks to compete to retain their share of the financial services market.

Unfortunately, H.R. 5094 would make it impossible to achieve the full benefits of Glass-Steagall reform, which this Committee has worked so long and hard to bring about. The proposed legislation is structured to limit the number of banks that could actually use new powers. It would do this by requiring a linkage between a bank's CRA rating and the approval of its holding company's applications to engage in permissible nonbanking activities. Under the proposed system, applications for permission to use the nonbank powers by bank holding companies with even average CRA ratings would be denied. These holding companies would not necessarily have failed to help meet community credit needs. They merely would not have done as much as some other bank holding companies on a relative scale.

Linking expanded powers and relative CRA ratings limits expanded powers to a specific group of banks. I believe that this effect would be as unnecessary as it is harmful. I share Congress' commitment to improved CRA performance: in the last two years, we have made important improvements in the OCC's performance of its responsibilities under CRA. Recognizing the need for improvement and the demands on our resources, we have revised our compliance examination program in a manner that we believe strikes the right balance between supervision for safety and soundness and for compliance. And unlike H.R. 5094, our approach encourages compliance both by banks that are interested in new powers and by those that are not. We know from conversations with bankers that our revised program and our focus on compliance matters have attracted the attention of the industry. These changes will, as we planned, result in a much higher level of compliance. Bankers are aware that we are serious about compliance, and we believe this has motivated them to take their responsibilities more seriously.

In view of complaints by community groups and press reports on the inadequacies, in some areas, of local lending activity by depository institutions, perhaps further improvements to our methods of compliance supervision would be beneficial. However, no case has been made for the kinds of dramatic changes mandated by the proposed legislation which would, among other things, force us to replace the reforms we have made even before the results of those reforms can be measured.

In the end, we must keep in mind that banks do not operate in protected markets that allow them to earn more than a competitive rate of return. If banks cannot make an adequate rate of return for investors, the investors will find other uses for their capital. Other providers of financial services are not subject to the same requirements and limitations on expansion of opportunities that are proposed in this legislation.

Now let me turn to my specific comments. Title IV contains six new regulatory provisions. Two of the provisions--Truth in Savings and Home Equity Loan requirements--have been examined in hearings in the House and are included in S. 1886. My statement today will focus on the major objections that I have with the provisions in Title IV that are new.

CRA CHANGES AND AGENCY REFORM

Summary of the Provisions

The first two subtitles of Title IV are designed to alter the implementation of CRA. Subtitle A would amend CRA and the Bank Holding Company Act in several important ways.

First, it would mandate a new, narrowly defined standard for evaluating the performance of depository institutions under CRA. The ratings would reflect CRA performance relative to banks with similar resources, ranging from excellent (1), through average (3), to poor (5).

Second, it would establish a strict "community benefits" requirement for depository institutions and holding companies seeking expansion or additional powers. Under the proposed legislation, the Federal Reserve Board would be unable to give final unrestricted approval to most bank holding company applications for an acquisition or to engage in nonbankin activities unless the holding company rating is at least a 2. Together with the proposed rating system, this requirement would mean that a bank holding company would have to be rated above average in order to engage i an acquisition or _de novo_ expansion or to enter into permissible nonbanking activities. Similarly, acquisition of a bank by other than a bank holding company would be allowed only with a commitment to maintain or raise the bank's rating to a 2.

Third, Subtitle A would place many specific requirements concerning the administration of CRA on the federal regulatory agencies. The legislation would require the collection of performance data on five CRA assessment factors. The agencies would be required to publish notices of the commencement of CRA examinations in newspapers and prepare and mail without charge to anyone who requests it, a bulletin--updated weekly--listing all banks for which notice had been published that week. At the conclusion of each examination, agencies would be required to prepare a written evaluation of the institution's CRA record and to make public certain portions of the evaluation, including the rating and the performance data. The agencies would be required to work jointly to develop and publish rating guidelines, and to review these guidelines annually.

Subtitle B would require the federal bank regulatory agencies to adopt a prescribed approach and organizational structure for handling consumer issues, including CRA. Each federal banking agency would be required to establish a separate "consumer division" meeting very specific criteria described in the legislation. The consumer division would: conduct a separate on-site consumer examination of each bank at least once every 24 months; be staffed by a cadre of specialist consumer examiners; be responsible for training, supervising, and developing career paths for consumer examiners; and respond to consumer complaints, enforce consumer and community reinvestment laws, and develop policies, regulations, and procedures concerning those laws.

THE OCC'S POSITION ON CRA CHANGES AND AGENCY REFORM

With the passage of Subtitles A and B, Congress would mandate a solution to a problem that it has not clearly defined. The CRA amendment, the Bank Holding Company Act amendment, and the agency reform provisions of H.R. 5094 certainly would change lending practices, but that change would be achieved at a very high cost.

Let me put this into perspective. There are legitimate needs for increased lending and increased sensitivity to credit needs in some communities. The OCC believes that banks must serve these communities, not only because it is the law, but also because it is good business. We do not believe, however, that legislation that could, in effect, allocate credit is appropriate. If that occurs, safety and soundness considerations may become secondary.

In order to give you an idea of how the proposed changes would alter the assessment process, I would like to explain to you the steps involved in the CRA portion of a compliance examination. Currently, the fundamental premise of the OCC's Compliance Program is that compliance is the responsibility of bank management. Accordingly, the focus of supervisory activity is to ensure that the bank has taken this responsibility seriously and has the procedures and accountability necessary to ensure a high level of performance.

Current Procedures for Assessing CRA Performance. Today, national banks are rated for compliance with CRA under five performance categories, which apply to all national banks regardless of size.

1. The bank is evaluated on its performance in determining the credit needs of its community and in marketing its services.

2. Examiners review the types and amounts of loans made and credit extended and the degree to which they are helping to meet the community's credit needs.

3. Examiners look at the geographic distribution of the bank's real estate loans and any practices meant to discourage applications, as well as the impact of opening and closing offices and the impact of terminating or expanding services offered at those facilities.

4. The bank's compliance with anti-discrimination and other credit laws is evaluated.

5. Examiners assess the bank's participation in community development and other factors related to meeting local credit needs.

Under the current procedures, national banks are responsible for providing examiners with the data that demonstrate performance in each category. An absence of this evidence is an indication that the bank's efforts may be inadequate and certainly indicates that its procedures need to be more formalized.

Examiners assess CRA performance based on twelve factors, each of which, in turn, is related to one of the five performance categories. (A list of the 12 assessment factors with the corresponding examination procedures for those factors is appended to this statement.) In forming their conclusions regarding a bank's CRA performance, examiners rely on their expertise and judgment and assign a numerical score for each category. Those five scores are then used to form the bank's overall CRA rating. No formula exists for translating the ratings for each category into the overall rating. Rather, the summary rating reflects the examiners' best judgment of overall CRA performance.

Implications of H.R. 5094 for Assessment of CRA Performance. The requirement to collect for publication performance data, particularly in the 1,300 national banks with assets in excess of $100 million, would materially change the focus of our examiners. Contrary to the assertions in the staff summary of the House Banking Committee's bill, we do not believe that most banks, even those with assets over $100 million, maintain the required data on sophisticated computer systems.

To illustrate what would be involved, consider that in order to identify loans to small businesses located in the bank's delineated community examiners would have to obtain listings of loans from each lending department. A listing for each department would be necessary because a small business working capital loan would be issued from the commercial loan department, but a loan for a delivery truck, for example, might be carried in the installment loan department, and a loan to finance the business plant might be located in the real estate loan department.

Once the listings, which may or may not contain street addresses, are obtained, examiners would need to obtain the credit file for each loan listed in order to determine if the loan is to a small business and, possibly, its address. Examiners would then need to determine if the address is located in the delineated community. Only after all of the loans in the portfolio had been accounted for, could the examiners attempt to determine if particular neighborhoods had been arbitrarily excluded from the bank's lending area.

Our examiners currently use less precise, but not necessarily less effective, procedures. Initially, examiners review reports of previous examinations and working papers from other consumer-related programs conducted during the on-going compliance examination. Examples include programs to evaluate compliance with the Truth-in-Lending Act, the Equal Credit Opportunity Act, and the Fair Credit Reporting Act. Typically the examiners will also analyze data compiled in accordance with the Home Mortgage Disclosure Act (HMDA), the OCC's Consumer Complaint Information System, and reports from our Consumer Examination Information System. Examiners also interview management and review internal files to determine the extent of lending in low- and moderate-income neighborhoods and the extent to which the bank may have failed to extend credit in those areas. Only in those cases where the examiners are not satisfied with the bank's performance in helping to meet local credit needs will a more technical analysis of specific loan data be undertaken.

Policy Concerns Created by H.R. 5094. In addition to the practical implementation problems discussed above, I see three other major problems presented by the new provisions. First, the proposed approach to assessment and enforcement would have the effect of changing the objectives of CRA from balancing competing goals to what amounts to legislative credit allocation. This change would result from the combined effects of the proposed CRA rating system, which would rank banks on a relative basis, the application of the "community benefits" test for acquisitions and expanded powers, and the publication of information on the CRA assessment.

Currently, the OCC uses the uniform interagency rating system for determining the CRA rating to be assigned to national banks. A rating is assigned to each national bank based on the institution's performance in helping to meet community credit needs. Banks may be given CRA ratings ranging from 1 to 5. A rating of 3 is given to banks whose CRA performance is less than satisfactory, meaning that, in the judgment of the examiner, the bank is not adequately helping to meet the credit needs of the community; a 5 rating represents a substantially inadequate record of helping to meet community credit needs. Ratings are assigned independently of the performance of other banks, that is without regard to achieving any expected distribution of ratings, within the context of the market it serves.

The rating system proposed in the House bill would impose a distributional standard. A bank's rating would depend on the comparative performance of other banks in its size category. It is not clear exactly how the rating process would work in practice. However, given the very specific data requirements imposed by the proposed CRA amendment, and the public disclosure requirements, we believe it is reasonable to expect that these performance standards will actually evolve to quotas for certain types of loan activity.

Since the legislation ties new powers to ratings, the relative nature of the performance standard could undermine safety and soundness of banks. It would not be good enough, under the legislation, for banks to meet the current test of satisfactorily helping to meet the credit needs of their communities. They would, as measured against their competition, be required to receive higher performance ratings than banks that are part of other holding companies. This requirement would encourage banks to see who could make the most loans of certain types--an incentive that has had disastrous consequences in other contexts.

The reliance of the proposed rating system on relative performance and the requirement that ratings and evaluation factors be made public could also result in an unintended change in the objectives of CRA, due to the underlying pressure to quantify performance. Because the rating methodology would need to be publicly defensible, regulatory agencies might tend to rely on the more easily quantifiable assessment factors. Because not all of the indicators of CRA performance are readily quantifiable, some important indicators, such as marketing efforts or director participation in formulating policies, could be given too little weight in the assessment process.

I am also concerned about the provisions of the bill that would require public disclosure of CRA ratings. First, there might be public confusion over the rating. If the CRA rating is misinterpreted as an indicator of the bank's health, confidence in the bank could be jeopardized. Second, an accurate assessment of a bank's CRA performance depends on a candid exchange between bankers and the examiners. Although we would hope that public disclosure would not diminish that candor, human nature being what it is, one has to believe that there will be some negative effect. Third, the threat of litigation, which would likely increase with public disclosure of ratings, could also threaten the thoroughness of examiners' evaluations. Finally, public disclosure could shift the focus of community groups' efforts from the bank's performance in helping to meet the community's credit needs to the numerical rating, and, consequently, the supervisory agency.

Another major concern with H.R. 5094 is that it would cause the OCC to use resources inefficiently. The provisions in Subtitles A and B would tell the banking agencies, in very fine detail, how to administer laws on consumer issues, resulting in a radical change from the current system, and mandate calendar-driven examinations of all banks. Clearly, if we exhaustively examined all banks on a regular schedule, we would catch most violators of the consumer banking laws, at least after the fact. But there is a better way--we do not have to use such an intensive application of our limited resources. Instead, the OCC relies on a combination of on-site activities and off-site evaluations of a bank's procedures and policies to assess bank compliance with consumer laws. Moreover, the bill's implications would encourage banks to request an updated CRA assessment, in anticipation of a corporate application. Currently, it would be impossible for us to meet those requests with our limited resources.

The heart of the OCC's approach to assessing the level of compliance with all laws and regulations, the Compliance Program, is the selection of a stratified random sample of national banks for an in-depth review of their compliance efforts and accomplishments. The uncertainty associated with being selected in the sample provides an incentive for compliance, without having to rely on regularly scheduled examinations, in the same way that the possibility of being audited by the IRS provides an incentive for compliance with the income tax laws. This process is described in detail in the report our Office submitted to this Committee in January of this year.

The final major policy concern is that the proposed reforms are based on an understatement of the cost burden to banks of CRA compliance. The proposed provisions try to dismiss concerns about cost and efficiency by shifting the burden of collecting compliance data to the banking agencies. That is simply unrealistic. In one way or another, banks will wind up paying the cost of increased compliance examinations. If the OCC does the work, we will ultimately charge banks for our time through assessments. It is clearly more efficient, and a better indication of bank management's commitment, for the banks to provide the data in support of their contention that they are helping to meet the credit needs of their community. Realistically, only the banks can provide the basic data necessary to evaluate their performance. This is the approach that the OCC encourages.

A perverse result of the incentives created by a desire to obtain relatively high CRA ratings is that the burden of the proposed data requirements would be borne more heavily by the better CRA performers. Banks with better CRA records would have more incentive to cooperate with the examiners and do the necessary groundwork to make the data available. Banks with worse CRA records would not have such an incentive. The result would be more work for the examiners and higher costs for the banks.

Ironically, there is one important sense in which the banks and their supervisors will not bear the entire cost of the reforms. As a practical matter, the regulatory agencies will have to absorb some of the costs of the proposed agency reforms--the costs of diverting management resources to the reorganization of the agencies, of using existing resources to initiate staffing, and of implementing the new policies. The resources necessary to accomplish those tasks would have to be diverted from our safety and soundness responsibilities at one of the worst times possible, a time when record numbers of banks have failed and a large number of problem banks need supervisory attention.

A complete overhaul of our system of compliance supervision--as mandated by the proposed bill--would come at considerable sacrifice to effective and adequate safety and soundness supervision. In view of the success of our current approach to compliance supervision, we believe that this is a sacrifice that should not--and need not--be made.

We do not need to introduce into the banking system any destabilizing forces--especially when the public is concerned about the safety of parts of the financial services industry. Such a restructuring would impose on the public at large the costs associated with a more risky banking system, an unintended outcome that would clearly be inconsistent with the intentions of the House Banking Committee.

NOTICE OF BRANCH CLOSURE

H.R. 5094 would require that a national bank notify its customers and the OCC of a proposed closing of either a staffed branch or an ATM at least 90 days prior to the proposed closing date. If the OCC receives a valid complaint about the closing of a branch, the bank would be required to provide a detailed analysis of activity at the branch for the preceding three years, with a projection of the expected level of activity if the branch remained open. The OCC would be required to determine if the closure would result in a serious reduction in the availability of services. If such a determination is made, the OCC would have to look into the feasibility of replacing the branch with other facilities, including establishing a community development credit union. These provisions would not apply in the case of emergency acquisitions.

The OCC's Position On Prior Notification

The OCC believes that banks should notify the public of plans to close branches, and we currently encourage national banks to advise the community of their plans to close branches or to reduce services. Through issuance of Banking Circular No. 189, assistance to trade groups writing handbooks on such programs, and by other means, the OCC has fostered national banks' efforts to develop and implement policies to notify the community of their plans to reduce or eliminate services and to help the community secure alternative sources of services.

It is not appropriate, however, for the OCC--or any other governmental body--to substitute its judgment regarding the location of banking facilities for that of the owners and managers of a bank. Banks are private businesses, and decisions to locate offices must be made with an eye towards the profitability of a particular branch and the efficiency of the overall operations of the bank. Although H.R. 5094 would not require OCC approval of branch closures, I am concerned that its somewhat imprecise language would have the effect of putting us in the position of second-guessing private, profit-motivated decisions.

Similarly, the provision of the bill that would require us to look into the feasibility of establishing alternative sources of services would inappropriately insert the OCC into actions that should be taken by the private sector, including the affected community. If some entrepreneurs believe that there are opportunities to serve profitably a market that has been abandoned by others, there are ample opportunities for them to act on that belief. Typically, markets that are underserved will attract new banking services either from de novo charters or branches of competitors. The initiatives of private entities in a community, including its citizens, community groups, and businesses--not of the government--are the best source of solutions to serving a community's needs for financial services. We believe that advance notification to customers and the affected community is sufficient to encourage such initiatives and would avoid imposing unnecessary administrative burdens on both the banks and the agencies.

I am also concerned that the branch closure provisions of H.R. 5094 apparently ignore the fact that banks' branching decisions reflect a more general restructuring of financial markets. As distinctions between formerly specialized financial institutions have eroded, banks and other providers of financial services have been forced to reconsider the means they use to deliver the services. Those changes, in large part, stem from the innovative use of new technology in supplying financial services and from changing patterns of competition among financial firms. New technology has enabled financial institutions to develop alternatives to relying on expensive brick-and-mortar branches for the delivery of financial services. For example, ATMs now offer consumers access to their accounts around the clock and in a variety of locations. Thus, one cannot assume that a commercial bank's branches are the only efficient suppliers of financial services to local areas and that without branches, services will not be available.

Finally, limitations on branch closing, whether direct or indirect, make it harder to withdraw from a market, short of failing. Such measures are always counter-productive, making marginally profitable branches more risky ventures.

BASIC BANKING SERVICES

H.R. 5094 would require banks to establish a "Basic Financial Services Account" for low- and moderate-income customers. This account would entail two separate services: a basic transaction service, and government check cashing services.

Depository institutions that ordinarily maintain checking accounts would be required to provide checking service to customers with $1,000 or less on deposit. The account could be opened and maintained with a balance of $25, and there would be at least ten free transactions per month. Banks would not have to pay interest on the account. The institution could offer, although it could not require, direct deposit of recurring government payments. It also could not restrict the customer to using automatic teller machines. The Federal Reserve would be authorized to establish service charges for this account.

Depository institutions that cash checks in the ordinary course of business would be required to offer the Government Check Cashing Service for federal, state, and local government checks of up to $1,500. When registering, the customer would designate up to three branches where checks could be cashed. A two-dollar service fee would be allowed per check.

For each of these services, customers would be required to provide photo identification bearing their signature and other basic data. The provision of these services would be subject to Federal Reserve regulation, and the bill provides certain safeguards against fraud or continuing abuse and against the establishment of any prerequisite for opening the account that would discriminate against low- and moderate-income individuals or those without other account relationships.

OCC Position

Government should not mandate services that have to be offered, just as it should not create artificial barriers to the kinds of services firms can offer, as it has to date in the area of securities and insurance. In the long run, these requirements lower the level of services, and the consumer loses. More importantly, it is not clear that Congressional action is needed to ensure that banking services are widely available. Many banks now offer a variety of low-cost, basic banking services. The OCC has encouraged them to do it. Much attention has been given to this need in communities. A 1987 study by the American Bankers Association shows that one of every two banks already offers basic banking services, including seven of every ten banks with over $1 billion in assets. In addition, the survey found that another six percent of all banks plan to start offering these services.

CONCLUSION

Mr. Chairman, I believe that the goals that could be attained by the repeal of the Glass-Steagall Act are of such importance that our attention should not be diverted from this task. We want the consumer benefits provided by a more competitive financial services industry. Indeed, S. 1886--by creating a more competitive financial services industry with respect to securities products--is a truly pro-consumer bill. I reiterate, however, with respect to the sale of insurance products, both the House and Senate bills are terribly anti-consumer and, in addition, discriminatory.

We need a healthy and efficient banking industry, and we need bank regulatory policies and structures that reduce inefficiencies in the market and reward efficient competitors while assuring safety and soundness. Community credit needs are important as well, but they are a separate matter. We must not limit our attainment of a modern banking system by linking it to the achievement of CRA objectives. We can meet both goals, but not under the structure that H.R. 5094 would provide.

H.R. 5094 would limit the number of banks that could utilize new powers, reducing the benefits of Glass-Steagall repeal. It would create new costs for all banks when such added costs make no sense. It would make bank regulators divert resources from the protection of safety and soundness. And it would change the objectives of CRA, increasing regulatory interference in private lending decisions in a way that would, we fear, undermine bank safety and soundness. For these reasons, I cannot support many of the provisions of Title IV of H.R. 5094.

The CHAIRMAN. Well, thank you very much, Comptroller Clarke.

Our next witness is Manuel Johnson, vice chairman of the Federal Reserve System.

Mr. Johnson, go right ahead.

STATEMENT OF MANUEL H. JOHNSON, VICE CHAIRMAN, FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Chairman, I appreciate this opportunity to appear before the Senate Banking Committee to address the various provisions of title IV of H.R. 5094, recently reported by the House Banking Committee.

In my testimony I will place special focus on the Community Reinvestment Act of 1977, which I will refer to as the CRA, and how CRA has been implemented and how we can approve its administration.

Giving this emphasis to my testimony, I do not intend to convey any lesser degree of concern about other provisions that were included in title IV of the bill.

Taken as a whole, these new provisions constitute a massive new burden on the banking system, particularly on smaller banks without the resources to handle these regulatory requirements.

I would encourage the committee to study the staff appendix to my submitted testimony in order to fully understand the impact of these provisions.

The CRA gives the Federal financial supervisory agencies a significant role on assuring that financial institutions identify and take steps to meet the credit needs of their local communities. The CRA does not impose any specific lending requirements on financial institutions. Instead, the purpose of the CRA is to encourage depository institutions to make meaningful efforts to assure that local communities are aware of available credit facilities and to take steps to meet local credit needs in a nondiscriminatory manner compatible with safe and sound operation.

The Board fully supports the purposes of CRA and strongly believes that all depository institutions should make meaningful efforts to meet these objectives.

The Board has taken three broad steps to implement these CRA policies. These steps include conducting specialized CRA performance examinations, a program for informing banks of their responsibilities under the CRA, and a program for reviewing applications that includes consideration of the CRA performance record of the banks and bank holding companies involved.

BOARD'S CRA EXAMINATIONS

The Board's CRA examinations establish a framework for regularly assessing the performance of State member banks in meeting the credit needs of their communities. The outreach program helps inform banks regarding effective methods of assessing the needs of their communities and methods that are available to meet those needs.

The applications process acts as an effective check on the performance of banks and bank holding companies that seek to expand and provides a vehicle for public participation in the review of the institutions' CRA performance.

The details of the Board's program in these three areas are explained in my submitted remarks.

From this experience in reviewing the CRA performance of banks through the examinations and the applications processes, the Board has found that institutions with the most effective programs to help meet community credit needs share a number of critical elements. Those institutions maintain outreach programs which include procedures to permit effective communication between the bank and various segments of the community, and they have formalized methods for incorporating findings regarding the community needs in the development and delivery of products and services.

Institutions with effective programs consistently monitor institutional performance at senior management levels, and they periodically evaluate new opportunities for innovative lending programs, including home mortgage and neighborhood residential rehabilitation lending.

Implementation of an effective program includes the use of specifically designed marketing and advertising plans to stimulate public awareness of the banks' services throughout the community, as well as active support of projects such as neighborhood and housing services programs and the development of policies to meet identified needs of low- and moderate-income persons.

While we believe that the current CRA policies and framework are fundamentally sound and workable, we recognize that improvements in the implementation of the CRA can be made. To this end, the Board initiated an ongoing study earlier this year of the Board's CRA programs and established a staff task force to identify model CRA programs and factors that are necessary for the implementation of a sound CRA program.

The Board has also considered changes in the law that would improve the current CRA process. We believe that the major criticisms of the CRA could be fully met by providing a mechanism that would permit the public to participate in the assessment of the CRA performance records of financial institutions.

PUBLIC PARTICIPATION

This could be effectively accomplished through the establishment of a two-stage procedure:

First the appropriate Federal financial supervisory agencies should publish approximately every 2 years an evaluation of each financial institution's record of performance under the CRA;

Second, the public should be invited to submit comments regarding this evaluation in the institution's performance record. As an essential part of this program, the Federal financial supervisory agencies would be required to take these public comments into account in reviewing expansion proposals by the institutions. In our view, this approach would provide a meaningful and highly effective method of communication among banks, communities, and regulators regarding the community's needs, the institutions' CRA plans and goals to address those needs, and the institutions' record of accomplishment in meeting their responsibilities under the CRA on a regular basis.

This approach also has the advantage of simplicity and could be incorporated into the existing framework established by the CRA as an effective substitute for many of the provisions of title IV of the House bill.

I would like to turn now to discussion of the provisions of title IV of H.R. 5094 and the Board's concerns regarding the likely effect of these provisions on the existing CRA framework.

TITLE IV HAS FOUR BASIC PROVISIONS

Title IV of the House bill establishes a framework that includes four basic parts:

First, the bill establishes data collection requirements in three specified lending areas;

Second, the bill requires a comparative evaluation of the resources devoted by banks of comparable size to these three lending areas;

Third, the bill imposes limitations on both banking and nonbanking expansion proposals, based on an institution's numerical CRA rating;

Fourth, the bill creates a number of complex and protracted procedures for analyzing applications submitted under the Bank Holding Company Act.

Although the House Banking Committee has adopted some improvements to title IV that reflect comments made by the Federal banking agencies and others, the Board believes that a number of significant problems continue to exist with the House bill.

As I have stressed, the major defect of the bill is that its proposed information collection requirements, CRA rating system, and limitations on the approval of expansionary programs by banks and bank holding companies will, taken as a whole, have the effect of requiring financial institutions to devote increasing amounts of resources to areas for which data is collected.

This is because under the system contained in the House bill it is impossible for a bank regulatory to give an above-average rating to an institution unless the institution has committed an above-average level of resources to three specific types of loans for which data is being collected.

In addition, by setting an average rating as the centerpiece of a comparative system, the bill will effectively force financial institutions to bid against similarly sized financial institutions for the above-average CRA ratings that are necessary to gain approval of expansion proposals.

This bidding process could raise significant safety and soundness concerns as financial institutions are forced to extend credit without regard to principles of safe and sound banking practices, in order to assure that the institution has devoted enough resources in these areas in comparison to its peers in order to obtain an above-average rating.

I would also like to stress our view that the procedures established by the House bill for reviewing applications by bank holding companies with an average CRA rating are exceedingly complex and would result in an excessively protracted administrative process.

The Board does not believe that the very small number of cases in which CRA comments are received warrants the significant increase in the public comment period in all cases reviewed by the Board, particularly in view of the added expense and burden that this extended delay would impose.

Moreover, we do not believe that the protracted review and hearing procedures established by the bill will result in public benefits that justify their added burdens and costs.

Finally, the Board is genuinely concerned that, in contrast to existing CRA provisions, many parts of the new statute do not recognize the existing obligation of banks to make credit decisions consistent with safe and sound banking practice.

Along with the suggestions I have made for increasing public participation in the assessment of the CRA performance of banks, other changes could be implemented to help make CRA more effective.

ADDITIONAL RECOMMENDATIONS

First, the specific data collection requirements of the bill should not be implemented. In place of this rigid format which has the effect of limiting lending flexibility, financial institutions should be permitted to collect and make publicly available whatever data is appropriate to demonstrate their record of meeting the credit needs of the community that the institution has identified and targeted.

Second, as a substitute for the comparative rating system proposed in the bill, Congress should adopt the procedure for public participation in the review of CRA performance that I have outlined. Clearly, the system centered on a rating defined as "average" and on a comparison of resources devoted by financial institutions should be eliminated.

The CHAIRMAN. Could you finish up in about a minute or so?

Mr. JOHNSON. Yes, sir.

Moreover, the bill must be changed to permit banks to recognize their obligation to make credit decisions consistent with safe and sound banking practice and must permit the Federal agencies to take these principles into account in evaluating the CRA performance of financial institutions.

Third, a 45-day public comment period might not be required in every case reviewed by the Board. Instead, the Board could be instructed to grant some extensions to the public comment period if a reasonable request for additional time has been made.

Finally, the complex and burdensome procedural requirements that the bill would impose on bank holding companies should be replaced by a direction to the Board to use its existing authority to enforce CRA commitments by bank holding companies.

I will skip to my summary.

A criticism today of some of the provisions of title IV of the House bill stems from our judgment that the policies and framework established by the CRA are sound and workable. The Board fully supports the basic purpose of the CRA of encouraging financial institutions to meet the credit needs of all segments of their local communities in a manner that is nondiscriminatory and consistent with the principles of safe and sound banking practice.

We recognize that some improvements can be made in the implementation of the policies of the CRA. In particular, we have offered detailed recommendations that include a new system of public participation in the assessment of the CRA performance of banks, elimination of rigid data collection requirements, adoption of provisions for granting requests by members of the public for extensions of the public comment period on applications, and use of the Board's authority to enforce bank commitments to improve CRA performance.

The objective of these suggestions is to improve communication between banks and all segments of the communities they serve and to assure that credit is available on a nondiscriminatory basis to creditworthy customers.

We stand ready to provide any assistance that we can in this area, Mr. Chairman.

Thank you.

[The complete prepared statement of Manuel H. Johnson follows:]

For release on delivery
10:00 a.m., E.D.T.
September 8, 1988

Statement by

Manuel H. Johnson

Vice Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

of the

U. S. Senate

September 8, 1988

Mr. Chairman, I appreciate this opportunity to appear before the Senate Banking Committee to address the various consumer provisions of Title IV of H.R. 5094, recently reported by the House Banking Committee. In my testimony, I will place special focus on the Community Reinvestment Act of 1977, which I will refer to as "the CRA", how CRA has been implemented, and how we can improve its administration.

In giving this emphasis to my testimony, I do not intend to convey any lesser degree of concern about other provisions that were included in Title IV of the bill which, in addition to those affecting the CRA, also impose new regulatory requirements in the areas of government check cashing, basic financial services accounts, bank branch closings, equal credit opportunity, and home equity loan requirements. Taken as a whole, these new provisions constitute a massive new burden on the banking system, particularly on smaller banks without the resources to handle these regulatory requirements. I will address our serious concerns about these extensive new regulatory requirements at the conclusion of my testimony, as well as in a staff appendix.

THE CURRENT CRA FRAMEWORK

Before discussing suggestions that have been made for revising the CRA, I think it would be helpful to outline briefly the responsibilities established under the current provisions of the CRA and to discuss the steps taken by the Board to implement these policies. This will provide a useful perspective on the types of bank CRA programs that the Board believes are effective and will serve as a guide for organizing a meaningful discussion of the House bill and other programs that have been suggested for revising CRA in the future.

The CRA gives the Federal financial supervisory agencies a significant role in assuring that financial institutions identify and take steps to meet the credit needs of their local communities. In particular, the CRA provides that the Federal financial supervisory agencies must assess the record of each institution under their supervision in meeting the credit needs of the institution's entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. In addition, the CRA requires that the Federal financial supervisory agencies take this record into account in evaluating an application by the institution for a deposit facility.

The CRA does not impose any specific lending or other requirements on financial institutions. Instead, the purpose of the CRA is to encourage depository institutions to make meaningful efforts to assure that local communities are aware of available credit facilities and to take steps to meet local credit needs in a nondiscriminatory manner compatible with safe and sound operation. The Board fully supports the purposes of CRA, and strongly believes that all depository institutions should make meaningful efforts to meet these objectives.

THE BOARD'S IMPLEMENTATION OF THE CRA

The Board has taken three broad steps to implement these CRA policies. These steps include conducting specialized CRA performance examinations, a program for informing banks of their responsibilities under the CRA, and a program for reviewing applications that includes consideration of the CRA performance records of the banks and bank holding companies involved. The Board's CRA performance examinations establish a framework for regularly assessing the performance of state member banks in meeting the credit needs of their communities. The outreach program helps inform banks regarding effective methods for assessing the needs of their communities and methods that are available to meet those needs. The applications process acts as an effective check on the performance of banks and bank holding companies that seek to expand and provides a vehicle for public participation in the review of the institution's CRA performance. The public has increasingly taken advantage of its ability to participate in the applications process, with the number of cases involvin CRA comments increasing from only 3 in 1984 to 35 in 1987.

The Board's CRA Examination Process

The first part of our CRA program involves examinati of the CRA performance records of state member banks. Thes examinations are carried out by examiners who are specifical trained in consumer compliance and CRA issues, and are conducted approximately every eighteen months in most cases, and more frequently in the case of banks with less satisfacto records.

CRA examinations conducted by the Board focus on a number of factors, and are designed to identify the general framework of an effective CRA program. They recognize that banks must be permitted the flexibility to meet the credit needs of the community in a way that is compatible with the bank's overall business strategy, and the community's needs.

Among the factors examined by the Board are the bank efforts to become aware of the credit needs of its community and to implement marketing and special credit-related program to inform members of the community of the credit services offered by the bank. In addition, the Board examines the bank's record of making loans within its community, includin low- and moderate-income neighborhoods, and the bank's participation in local community development projects, and governmentally insured, guaranteed or subsidized loan programs

The examination also focuses on the geographic distribution of the bank's credit extensions, and the existence of any evidence of discriminatory or other illegal credit practices by the bank. Finally, the examiners take into account other information that relates to the bank's record of meeting the convenience and needs of its entire community, including the bank's record of opening and closing offices. These assessment factors have been incorporated in the Board's Regulation BB governing CRA matters.

As part of the examination process, our examiners contact members of the communities in which they conduct examinations -- including local government agencies, small businesses, grassroots community organizations, and others -- in an attempt to understand the needs of the community the bank serves. The examiners then discuss the performance of State member banks under the CRA with the bank's management in light of the examiner's contact with the community, and provide both written and oral reports to the management. These examination reports are intended to inform the bank's management of both the strengths and weaknesses of the financial institution's CRA compliance efforts and to suggest particular steps that management may take to enhance that performance. Where deficiencies are noted in the examination, the Reserve Bank continues supervisory attention until improvement has been achieved.

The Board's continued attention to CRA performance by our examiners has, I believe, emphasized to state member banks that we are serious about CRA and that we expect these banks t maintain responsible CRA programs. We also believe these efforts have been useful to the banks in designing effective CRA programs and, therefore, have resulted in benefits to loca communities.

Community Outreach Programs

The second step taken by the Board to implement the policies of the CRA is the establishment at each of the Reserv Banks of Community Affairs Officers who provide information about community development strategies and techniques to banks, bank holding companies, and others. One of the goals of the System's community affairs program is to become familiar with the credit needs of the cities, towns, and rural areas in the Federal Reserve districts through outreach to those areas. Once having identified these needs, our community affairs officers help banks to construct programs that will identify and address community credit needs.

For example, over the last three and one-half years the program has sponsored 120 conferences and seminars on opportunities and techniques for community development lending and other related subjects. In 1987 alone, the Community Affairs Officers at the Reserve Banks sponsored over 60 seminars and workshops that explored a variety of topics related to community investment, community revitalization, and rehabilitation financing. During 1987 the staff at the Reserve Banks spoke before more than 100 groups, most of which represented bankers, concerning the CRA.

The Reserve Banks have also undertaken additional initiatives, such as publishing periodicals that deal with community lending, producing resource books on the programs for community development lending in which a bank might wish to participate, forming community lenders forums to provide mutual education about community development opportunities and techniques, and producing community profiles designed to help lenders and others in the community know what the needs are, what resources are available and what contribution the various participants might make.

One activity in this area that I would particularly like to mention is our work with community development corporations. Since well before the advent of CRA, the Federal Reserve and the Comptroller of the Currency have allowed and encouraged the creation by bank holding companies and national banks of community development corporations. Community development corporations -- or "CDCs" as they are called -- are corporations chartered to bring the lending, financial packaging and other special talents of the banker to bear on specific community projects. CDCs may focus, for example, on special community needs such as low-income housing or small business revitalization.

These corporations have the potential for making important contributions to community revitalization, in part because they are given unusual authority, such as authority to take equity positions and own real estate. The Federal Reserve and the Comptroller's office cosponsored a conference in August of 1987 dealing with CDCs, which was attended by about 200 bankers. A pamphlet containing the proceedings of that conference was produced and widely distributed. Since that time we have seen a great deal of interest particularly in the formation of national banks.

Community outreach efforts such as these are, we believe, an essential element of our charge under the CRA to encourage financial institutions to meet the credit needs of their communities.

Consideration of CRA Performance in the Applications Process

The third facet of our approach to implementing CRA involves consideration of the CRA performance records of banks in connection with applications received by the Board under the Bank Holding Company Act and the Bank Merger Act. CRA performance is taken into account along with financial, safety and soundness, managerial, and competitive factors, when the Board reviews these applications.

Through its experience in examining the CRA performance of banks, the Board has found that institutions with the most effective CRA programs share a number of critical elements. These institutions:

1. maintain outreach programs that include procedures to permit regular, ongoing and meaningful communication between all levels of management of the bank and members of the community, community-based organizations, businesses, local agencies and others for the purpose of ascertaining local credit and deposit needs, including, particularly, the credit needs of low- and moderate-income neighborhoods;
2. establish formalized methods for incorporating the findings regarding community credit needs gathered through these outreach efforts into the institution's development and delivery of products and services to all segments of the community;
3. study opportunities for innovative lending programs for low- and moderate-income neighborhoods, including home mortgage neighborhood and residential rehabilitation lending;
4. support community development projects, such as Neighborhood Housing Services Programs, and develop policies to meet specific, identified needs of low- and moderate-income persons;
5. through specifically designed marketing and advertising programs, stimulate public awareness of the bank's services throughout the community, including efforts targeted to low- and moderate-income neighborhoods and groups;
6. establish systems for monitoring the institution's performance at senior management levels and periodically assessing areas for improvement; and,
7. train employees regarding the lending opportunities offered through the institution as well as the availability of community and local development programs.

It has been the Board's practice in the applications process, as a general matter, to work with institutions to improve their CRA performance. The Board's experience has been that a significant and growing number of banks and bank holding companies have adopted formal and detailed internal policies and programs to address their responsibilities under the CRA.

Where the Board has found inadequacies in a bank holding company's performance or program in the context of an application before the Board, these institutions have made commitments designed to improve the institution's CRA performance and to permit the Board to proceed to review the application. Usually these commitments have addressed many of the concerns raised by public comments, as well as those expressed by the Board in similar applications.

While the commitments vary from case to case depending on the particular facts, commitments generally relate to establishing or improving programs for ascertaining the credit needs of the community; implementing programs to make the community more aware of the institution's credit services through newspaper and radio advertisements, brochures, posters, or officer call programs; improving internal procedures for reviewing and implementing CRA policies; and, finally, in some cases, improving certain types of lending where the record indicated that the applicant had not been active in making loans in areas where the applicant had itself identified a need in its CRA statement. Although protestants sometimes request that the applicant also reduce interest rates or relax credit standards, the Community Reinvestment Act and the Bank Holding Company Act do not authorize the Board to establish the terms or conditions of loans, nor does the Board believe that this was the intent of Congress in enacting the CRA.

An essential part of this process are the affirmative steps that the Board takes to assure that institutions fulfill commitments made during the applications process. In particular, the Board often requires special periodic reports from the applicant regarding progress in implementing the commitments. The Board examiners also review compliance with the commitments during periodic CRA examinations of state member banks. In addition, the Board will check for adherence to the commitments -- and take into account efforts to fulfill these commitments -- the next time the institution submits an application.

In fact, we have observed that banks have improved the attention and resources devoted to the credit needs of their communities, including low- and moderate-income neighborhoods. For example, home mortgage lending in low- and moderate-income areas has increased steadily and substantially during this decade. Despite increasing competition by other financial service providers, banks have maintained their predominant position in the field of small business lending, outstripping other financial service providers by a wide margin. Furthermore, banks have consistently been the predominant lenders in the Small Business Administration's lending programs. Forty-four of the fifty-five national bank and bank holding company community development corporations have been formed since the CRA was enacted in 1977. Banks have been among the primary lenders for projects undertaken under the

Department of Housing and Urban Development's Urban Development Action Grant program, and have been substantial financial contributors to the Neighborhood Housing Services programs around the country.

In our view, the results achieved through our efforts to implement the current provisions of the CRA are substantial. Viewed from the perspective of the objectives of the CRA that I outlined this morning, the Board's implementation program must be viewed as successful. As I said at the outset, the purpose of the CRA is to assure that banks take steps to identify the credit needs of the community, make all segments of the community aware of the credit facilities offered by the bank, and meet the credit needs of creditworthy members of all segments of the community in a nondiscriminatory manner. We believe that our CRA program has made important contributions to achieving these goals.

RECOMMENDED IMPROVEMENTS IN THE CRA

We recognize that improvements in the implementation of the CRA can be made, but we do not see a need for major revision of the CRA. We believe that the current CRA policies and framework are fundamentally sound and workable. Any modification to that system must be carefully tailored not to upset the balance between the needs of local communities and the safe and sound operation of banks, or to raise administrative obstacles that may tend to erase the gains already achieved by the CRA.

It is from this perspective that the Board believes modifications of the CRA must be viewed. With these objectives in mind, the Board initiated an ongoing study earlier this year of the Board's CRA programs, and established a staff task force to identify model CRA programs and factors that are necessary for the implementation of a sound CRA program. The Board believes that this self evaluation, which is based on 10 years of experience with the CRA, will lead to further improvement in the Board's implementation of the CRA.

The Board has also considered changes in the law that would improve the current CRA process. We believe that changes in CRA should focus on two criticisms of the existing CRA process: that there is not enough opportunity for individuals and community groups to have input into the evaluation of CRA performance of institutions, and that high CRA examination ratings are commonplace. We believe that these criticisms could be fully met by providing a mechanism that would permit the public to participate in the assessment of the CRA performance records of financial institutions.

This could be effectively accomplished through establishment of a two stage procedure. First, the appropriate Federal financial supervisory agencies should publish, approximately every two years, an evaluation of each financial institution's record of performance under the CRA. This evaluation would provide the public with the basis for the regulatory agency's analysis of the CRA performance of each financial institution. Second, the public should be invited to submit comments regarding this evaluation and the institution's performance record. As an essential part of this program, the Federal financial supervisory agencies would be required to take these public comments into account in reviewing expansion proposals by the institution.

In our view, this approach would provide a meaningful and highly effective method for communication among banks, communities, and regulators regarding the community's needs, the institution's CRA plans and goals to address those needs, and the institution's record of accomplishment in meeting their responsibilities under the CRA on a regular basis.

It would also assure the advantage of increased public participation without establishing a complex system that relies on credit allocation or intricate administrative procedures that are designed to enforce CRA compliance by imposing the possibility of costly delays. Moreover, this approach has the advantage of simplicity, and could be incorporated into the existing framework established by the CRA as an effective substitute for many of the provisions of Title IV of the House Bill.

ANALYSIS OF TITLE IV OF H.R. 5094

I have tried to paint a background that describes current CRA policy and the Board's implementation of that policy and explains the areas that the Board believes could be improved. I would like to turn now to a discussion of the provisions of Title IV of H.R. 5094 and the Board's concerns regarding the likely effect of these provisions on the existing CRA framework.

I hope the Committee will bear with me while I take a few minutes to explain the complexities of the House Bill, because it is so important that Congress understand the full ramifications of the Bill's exceedingly complex and procedurally burdensome framework of data collection, CRA performance evaluation, and new administrative requirements.

Summary of Title IV

Title IV of the House Bill establishes a framework that includes four basic parts. These parts include:

1. data collection requirements in three specified lending areas;
2. a comparative evaluation of the resources devoted by banks of comparable size to these three lending areas;
3. limitations imposed on both banking and nonbanking expansion proposals based on an institution's numerical CRA rating; and
4. the establishment of a number of complex and protracted procedures for analyzing applications submitted under the Bank Holding Company Act.

The first part of the House proposal requires institutions to collect data regarding their housing loans in low- and moderate-income neighborhoods, small business loans and small farm loans, as well as investments in community

development projects and associated activities in these thre
specific areas. While data collection alone is only
burdensome, when combined with other parts of the bill, thes
requirements move the CRA away from its present emphasis on
expanding awareness of credit granting opportunities toward
directed lending for specific purposes.

Second, the bill requires that the Federal financia
institutions supervisory agencies prepare and make available
the public evaluations of the record of depository institutio
in meeting the credit needs of their communities, placing
special emphasis on the specific types of loans for which dat
collection requirements are set under the bill. The proposa
revises the current CRA rating system to provide a comparativ
system that requires institutions of the same size to devote
comparable resources to community investment activities. Th
system includes five rating categories: two above-average
ratings, an average rating, and two below-average ratings.

Third, the House bill would require as a prerequisit
to any banking or nonbanking expansion that bank holding
companies have an imputed CRA rating that is above average on
comparative basis with institutions of similar size.
Institutions with an average CRA rating could be granted
preliminary approval to expand their nonbanking and interstat
banking activities provided that they commit to implement
policies that will improve their CRA performance. The bill
establishes a complex procedure for monitoring compliance wit

these commitments. Institutions with a below average CRA rating would be prohibited from acquiring other financial institutions on an interstate basis or from expanding their nonbanking activities. A detailed and extended process would be established to permit these institutions to acquire additional banks within their home state provided they commit to improve their CRA performance.

Finally, the bill would revise the applications process under the Bank Holding Company Act in several key respects. The bill would extend to 45 days the period during which the public may submit comments regarding any proposal requiring Board approval under the Bank Holding Company Act except simple reorganizations. In addition, the bill would establish a formidable procedure spanning a course of two years and involving public comment, two stages of Board review and a mandatory public hearing in cases involving acquisitions by bank holding companies with an average or below average CRA performance rating.

MAJOR AREAS OF CONCERN

Although the House Banking Committee has adopted a number of improvements to Title IV that reflect comments made by the federal banking agencies and others, the Board believes that a number of significant problems continue to exist with the House bill. There are five areas of major concern:

1. The provisions of the bill will work together to establish a system of credit allocation.
2. The extended comment period required in the Bill for all applications submitted under the Bank Holding Company Act will impose unnecessary costs and burdens on applicants with no practical benefit to the public.
3. The comparative rating system has the anamolous effect of putting banks in an inappropriate competitive CRA performance race, and by complex procedures prevents so-called "average" performers from undertaking any expansion.
4. The protracted preliminary review and post-approval hearing procedures established by the Bill are excessively burdensome.
5. In contrast to existing CRA provisions, many parts of the new statute do not recognize the existing obligation of banks to make credit decisions consistent with safe and sound banking practice.

Our staff has prepared a more detailed Appendix discussing a number of other difficulties that we see in the implementation of Title IV.

As I have stressed, the major defect of the Bill is that its proposed information collection requirements, CRA rating system, and limitations on the approval of expansionary programs by banks and bank holding companies will, taken as a whole, have the effect of requiring financial institutions to devote increasing amounts of resources to areas for which data is collected. This is because, under the system contained in the House bill, it is impossible for a bank regulator to give an above average rating to an institution unless the institution has committed an above average level of resources to three specific types of loans for which data is to be collected.

By tying the data collection and rating system to three specific loan categories, the bill departs from the existing CRA philosophy, which permits banks to meet the needs of the community in a variety of ways, from purchasing low income housing bonds to making business loans in minority areas. It will, thus, stifle the ability of financial institutions to specialize in certain particular banking areas and to shoulder their CRA responsibility in a manner consistent with their business strategy. We are also concerned that credit needs of the community in other areas may go largely unmet by banks because resource commitments in these other areas clearly are given only minor significance under the rating system established in the House bill. Thus, the effect of the bill will be to establish Congressionally mandated direction of credit for specific purposes and to remove the flexibility that banks currently have to identify and meet special needs of their community in a manner that takes advantage of the special skills and resources of individual banks.

This system is made worse by the Bill's use of a comparative CRA rating system that limits the ability of institutions with an average CRA rating to expand. The House bill requires the agencies to grade financial institutions by comparing the resources devoted by the institution to community investment activities, particularly in the three specified areas for which data is collected, to the resources committed by similar size institutions.

The Bill also establishes a base rating of "average" on this comparative scale and limits the ability of institutions with a performance rating of average or below average from expanding their banking or nonbanking activities. By setting an "average" rating as the centerpiece of a comparative system, the Bill will effectively force financial institutions to bid against similarly sized financial institutions for the above average CRA ratings that are necessary to gain approval of expansion proposals. The Board is very concerned that this comparative rating system will force financial institutions to extend credit without regard to principles of safety and soundness in order to assure that the institution has devoted sufficient resources to the Bill's three specified lending areas in comparison to their peer's in order to obtain an above average CRA rating.

The Board believes that this system is also defective because the complex and protracted application process established by the House bill for proposals involving acquisitions by bank holding companies with an average CRA rating effectively makes the average rating unsatisfactory in all meaningful respects. Any CRA rating that is not "above average" -- whether it is a rating of average or poor -- will, in practice, have the same result of preventing the institution from taking advantage of opportunities to expand into new geographic locations and new nonbanking areas.

The Board is also concerned that, taken together, the impact of this Bill will act as a tax on financial institutions that will reduce the ability of regulated financial institutions to compete effectively against unregulated entities that provide similar products and services. This would ultimately hurt all segments of the consuming public.

The House Bill also establishes an excessively elaborate system of procedures for evaluating and considering the CRA records of financial institutions. The Bill would establish a minimum public comment period of 45 days for all applications or notices submitted to the Board to acquire banks under section 3 or to expand nonbanking activities under section 4 of the Bank Holding Company Act.

In addition, the procedures established by the House Bill for reviewing applications by bank holding companies with an average CRA rating are also exceedingly complex and would establish an excessively protracted administrative process. In these cases, the Bill establishes a preliminary approval process in which the acquiring bank holding company is permitted to commit to specific proposals designed to improve its CRA performance. In addition to initial public comment and review of the proposal and CRA commitments, the Bill imposes a re-review process of the acquisition and commitments six months after the acquisition has been consummated, and mandates a public hearing on the proposal two years after the acquisition has been completed.

The Board does not believe that the very small number of cases in which CRA comments are received warrants a significant increase in the public comment period in all cases reviewed by the Board, particularly in view of the added expense and burden that this extended delay would impose. The Board could simply be directed to use its existing authority both to permit members of the public additional time to comment on applications before the Board and to assure that commitments made by bank holding companies during that process are met.

The protracted re-review procedure established by the Bill introduces substantial uncertainty into the approval process and could extend that regulatory review process far beyond the time horizon of most investors. In our view, permitting the public to participate in assessing the CRA performance of the bank holding company in the manner I proposed earlier would provide a better vehicle for permitting public participation in the enforcement of CRA commitments.

Title II of S. 1886 makes significant strides toward streamlining the review process under the Bank Holding Company Act and reducing the costs associated with the applications process. The Board has fully supported these provisions of the Senate bill. The needless extension of the comment period and the complex review procedures established for certain expansion proposals that have been proposed in the House bill, however, would largely vitiate the gains made by the expedited procedures process established in S. 1886.

Suggestions for Modification of Title IV

Along with the suggestions I have made for increasing public participation in assessing the CRA performance of banks, other improvements are needed to deal with the problems I have raised. First, the specific data collection requirements of the Bill should be eliminated. In place of this rigid format, which has the effect of limiting lending flexibility, financial institutions should be permitted to collect whatever data is appropriate to demonstrate their record of meeting the credit needs of the community that the institution has identified and targeted. The institution could be required to make this data available in summary form for inspection by the public as part of the institution's CRA program.

Second, as a substitute for the comparative rating system proposed in the Bill, the Bill should adopt the procedure for public participation in the process for examining the CRA performance of financial institutions that I have outlined. Clearly, the system that is centered on a rating defined as "average", and on a comparison of resources devoted by financial institutions should be eliminated. Moreover, the Bill must be changed to permit banks to recognize their obligation to make credit decisions consistent with safe and sound banking practice and must permit the federal agencies to take these principles into account in evaluating the CRA performance of financial institutions.

Third, a 45-day public comment period should not be required in every case reviewed by the Board. Instead, the Board could be instructed to grant extensions of the public comment period whenever a request for additional time has been made and a reasonable showing has been made that an extension is appropriate.

Finally, the complex and burdensome procedural requirements that the Bill would impose on bank holding companies that do not achieve an above average CRA performance rating should be replaced by a specific direction to the Board to use its existing authority to enforce commitments by bank holding companies to improve their CRA performance offered in connection with applications and notices submitted under the Bank Holding Company Act.

COMMUNITY REVIEW BOARDS

The House Bill also makes a number of changes in other areas. I would like to discuss only a few of these. First, the bill would require each Federal Reserve Bank to establish a community review board that would advise each of the Federal depository institutions regulators of the needs of consumers and communities within the Reserve Bank district and would review the agencies' performance in implementing the policies of the CRA. We believe these boards, as constituted, are not well suited to the mission assigned to them, and would duplicate work already done by the existing Consumer Advisory Council.

The regional focus of these review boards is too narrow to provide meaningful advice on examination standards and practices, which must be uniform across the country. We believe the Board's Consumer Advisory Council already serves this function. These review boards are also ill-suited to advise the Reserve Banks on local issues, which can be effectively surveyed only by an extensive outreach program that includes contact with as many communities as possible. The Board believes that its existing Community Affairs Officers and outreach programs provide the most effective methods of assessing these varied needs. In this regard, we note that the Federal Advisory Committee Act embodies a congressional policy to avoid the creation of new advisory committees where the functions could be performed by an advisory committee already in existence.

GOVERNMENT CHECK CASHING

The House Bill would require financial institutions to establish a program for cashing government checks. The Board does not, in principle, favor a statutory requirement that mandates the provision of certain services at a specified price. The Board recognizes that many of the changes made in the final version of the Bill are helpful in reducing the potential for fraud that is associated with these programs. But the risk of fraud remains a real concern in a situation in which banks are required to provide immediate cash to where the authentication of the check being offered may be difficult to verify, and the identification procedures are subject to abuse.

The Board questions, however, whether focusing exclusively on check cashing is the best approach to the problem of delivering government payments in a reliable and efficient manner. We believe that electronic alternatives represent a much better long-term solution to problems in this area. Any legislation on the subject should provide some sort of encouragement to develop more innovative ways of delivering government payments.

For example, consideration should be given to the development of arrangements whereby federal, state, and local benefit payments could be electronically transferred to depository institutions that have agreed to participate in a voluntary program. The cost to the banking industry to process an electronic payment is much lower, and, consequently the fee charged to the individual would probably be considerably less than the $2.00 charge now permitted in the House bill for cashing a government check.

BASIC BANKING

Similarly, the Board believes that it is inappropriate to require depository institutions to offer basic transaction accounts at a given price. Our concern is that any mandatory arrangement will be both static and inflexible and that transaction account fee requirements will be extremely difficult to implement in regulations. In light of these problems, the Board believes that voluntary efforts by financial institutions to offer basic low-cost accounts are the appropriate response. Surveys indicate that as many as 50 percent of financial institutions voluntarily offer basic banking services, and that more institutions establish these types of programs every year. The Board believes that the trend will increase and can be encouraged without legislation mandating a specific program of services and fees.

EXPEDITED FUNDS AVAILABILITY AMENDMENTS AND OTHER PROVISIONS

The House bill contains a number of amendments to the Expedited Funds Availability Act. For the most part, these amendments facilitate compliance with the Act's requirements and reduce the risk of fraud in accepting checks that must be given next-day availability. The Board supports these amendments, and believes that Congress should act on them quickly.

The Board continues to be concerned, however, about the treatment of payable through drafts under the Act. The House bill contains an amendment that would explicitly codify a recent decision by the U.S. District Court that credit union share drafts that are payable through another bank be treated as local or nonlocal checks based on the location of the credit union, rather than the payable through bank.

The Board believes that under this approach, it is difficult for consumers to understand when the proceeds of credit union payable through share drafts are available for withdrawal, it is difficult for depository institutions to comply with the Act, and the risk associated with accepting these drafts for deposit is increased. Therefore, the Board recommends that Congress adopt an amendment clarifying the Act to provide that, in the case of payable through drafts that are payable by a depository institution, the determination of whether the draft is local or nonlocal be based on the location of the payable through bank.

With regard to the provisions on Truth in Savings, home equity lines of credit, and the Equal Credit Opportunity Act, which are discussed in the attached Appendix, the Board supports the need for full disclosure to consumers about the terms of their deposit and credit accounts, but we question the need for substantive limitations on institutions' practices

CONCLUSION

Our criticism today of some of the provisions of Title IV of the House Bill stems from our judgment that the policies and framework established by the CRA are sound and workable. The Board fully supports the basic purpose of the CRA of encouraging financial institutions to meet the credit needs of all segments of their local communities in a manner that is nondiscriminatory and consistent with the principles of safe and sound banking practice. We believe that our current system of examinations, community outreach programs, and review of applications is well suited for this purpose and has been successful in encouraging banks to increase their commitment of resources to community needs including low- and moderate-income neighborhoods.

The changes in the CRA that are proposed in the House Bill go far beyond the alterations that we believe can be justified by our experience in administering and reviewing compliance with the CRA. These changes upset the balance established in the CRA between the responsibility of financial institutions to serve the needs of all segments of their communities and the principles of safe and sound banking. In the process, the House Bill establishes a framework that tends toward credit allocation and erects formidable procedural obstacles.

We recognize that some improvements can still be made in the implementation of the policies of the CRA. In particular, we have offered detailed recommendations that include a new system of public participation in assessing a bank's CRA performance, elimination of rigid data collection requirements, adoption of provisions for granting requests by members of the public for extensions of the public comment period on applications, and use of the Board's authority to enforce bank commitments to improve CRA performance. The objective of these suggestions is to improve communication between banks and all segments of the communities they serve, and to assure that credit is available on a nondiscriminatory basis to creditworthy customers.

We stand ready to provide any assistance that we can in this area.

Appendix to
the Statement by
Manuel H. Johnson
Vice Chairman, Board of Governors of the Federal Reserve System
before the
Committee on Banking, Housing and Urban Affairs
of the
U.S. Senate
September 8, 1988

September 8, 1988

APPENDIX TO GOVERNOR JOHNSON'S TESTIMONY ON COMMUNITY REINVESTMENT ACT

Title IV of H.R. 5094 contains numerous technical problems and provisions that are cumbersome, excessively complex, and, in several cases, inconsistent. This appendix attempts to identify these problem areas.

Subtitle A

1. Section 11(a)(3)(B) in Section 403

A. The provisions of this section of the bill require the Board to issue public written findings regarding all factors that the Board is required to take into account in considering all applications under the Bank Holding Company Act ("BHC Act"). That provision would require the Board to make these findings within 15 days following the close of the public comment period on any application or notice in which no public comments are received by the Board regarding the CRA performance of the bank or bank holding company involved in the acquisition. The Bill permits additional processing time for cases in which the Board receives comments regarding the CRA performance of banks involved in the application or notice.

However, the Bill provides no similar exception for cases involving significant managerial, financial, competitive or other issues that are the subject of substantial comment. Thus, under this section of the Bill, the Board would be required to make findings regarding the financial, managerial, competitive and other factors the Board must consider under the BHC Act within 15 days of the close of the comment period in spite of the fact that the Board may have received substantial comments on these issues. This short period simply does not permit the Board sufficient time to consider and analyze these issues in a responsible way.

In addition, a requirement that the Board issue written findings in addition to its written statement in the final order regarding the case would cause needless duplication and may encourage disruptive and untimely litigation regarding these findings before the Board has issued its final order deciding the merits of the application or notice.

B. The Bill also requires the Board to act within 90 days of the start of the public comment in cases in which the Board holds a public hearing on CRA matters. This 90 day period also permits only an unreasonably short period of time for holding a full public hearing. Because comments are often received at the end of the comment period, the provisions of the Bill would require the Board to investigate, organize, and hold a hearing, as well as issue its findings following the hearing, within 45 days.

2. Section 11(a)(1)

The provisions of the Bill apply only to acquisitions that are subject to the Bank Holding Company Act, and do not apply to acquisitions that are subject to the Bank Merger Act. Consequently, a bank may acquire control of another bank through merger without complying with the CRA provisions of Title IV. The provisions of section 11(a)(1)(A)(ii) of section 403, which apply to applications by any bank to acquire control of another bank, would not reach bank-to-bank mergers because those mergers are not subject to section 3 of the Bank Holding Company Act. That section of Title IV would apply only in the event that a bank were to itself become a bank holding company by acquiring shares of another bank.

3. Section 11(a)(1)(B)

This section applies the provisions of Title IV to any application or notice by a bank holding company to acquire any company or engage in any activity described in "any paragraph of section 4(c) of the BHC Act." This provision inappropriately reaches not only acquisitions and expansion proposals but other matters as well. For example, this provision may be read to apply the CRA provisions of Title IV to a request by a bank holding company under section 4(c)(2) of the BHC Act for an extension of time to retain shares of stock acquired in satisfaction of a debt previously contracted. This would also require the Board to apply the CRA provisions to proposals by a domestic bank holding company to make an investment entirely outside of the United States under section 4(c)(13) of the BHC Act. In addition, it would require application of the CRA rules to an application by a foreign organization for an exemption under section 4(c)(9) of the BHC Act from the nonbanking restrictions of the BHC Act to engage in nonbanking activities outside the United States.

4. **Section 11(a)(1) & (3)**

A. Two provisions of section 11 imply that applications are required under the BHC Act where in fact no application is required. First, section 11(a)(1)(A)(i) applies the CRA provisions to any application under section 3(a) "to acquire control of another bank (other than a bank described in [section 2(c)(2) of the BHC Act] . . . ." Institutions defined in section 2(c)(2) of the BHC Act are not "banks" for purposes of section 3 of the BHC Act by definition, and no application under section 3(a) is required by a bank holding company to acquire these institutions. Rather, the acquisition of these institutions is subject to section 4 of the Act. By giving an express exemption to the acquisition of these institutions in section 11(a)(1)(A), Title IV implies that these institutions are "banks" subject to section 3 of the BHC Act.

B. Similarly, section 11(a)(3)(A) provides an exception for any notice by a bank holding company to engage in certain bank servicing or safe deposit box activities under the Board's regulations. Bank holding companies are expressly authorized by section 4(c) of the BHC Act to engage in these activities without prior Board approval. Inclusion of an exemption from the CRA title for these provisions suggests that the Board should require an application in these cases and should review the other non-CRA factors in these cases, when in fact the statute already provides that no application is required to engage in these activities.

5. Section 11(b)

The provisions of section 11(b) permit the Board to grant preliminary approval of applications involving acquisitions by bank holding companies with an imputed CRA of 3 where the bank holding company has made commitments that would improve its CRA performance to one of the above average ratings. The Board must re-review this determination at the end of the 180 day period following the preliminary approval, and must hold a public hearing regarding the application two years following the preliminary approval.

This procedure is excessively complex and protracted, and introduces severe burdens and uncertainty into the applications process. There appears to be no useful purpose for requiring the Board to re-review the sufficiency of commitments to improve CRA performance 180 days after the Board has originally reviewed and approved these commitments.

Moreover, requiring a public hearing regarding an acquisition two years following its consummation eliminates the ability of interested members of the public to introduce evidence that would permit denial of the application. The prospect of a public hearing after such an extended period of time is also likely to discourage bank holding companies that would be subject to this process from ever beginning the process because of the implication that the transaction may be subject to continued review over a protracted period of time.

The Board believes that its existing procedures are adequate in this area. First, the Board has long experience in reviewing the adequacy of commitments offered to improve the CRA record of organizations involved in an expansion proposal. The Board's ability to review these commitments is not enhanced by having two opportunities, 180 days apart, to review these commitments.

Second, the Board has ample authority to enforce commitments accepted by the Board in connection with an application under the BHC Act. The Board regularly requires organizations that make CRA commitments to submit special reports to the Board demonstrating their compliance with the commitments. These special reports, coupled with the Board's enforcement authority under the BHC Act, are adequate to assure that organizations comply with commitments they have made with the Board.

6. Section 11(a)(7)

A. Section 11(a)(7) establishes a procedure for certain acquisitions involving banks with CRA ratings of less than 3. Paragraph (B) of this subsection would permit "any bank holding company [to acquire] control of any bank with a community reinvestment rating of less than 3", if the acquiring bank holding company provides commitments that would improve the CRA rating of the organization. This provision, by its literal terms, would permit a bank holding company with a CRA rating that is below average to acquire a bank with a CRA rating that is below average, while prohibiting that same bank holding company from acquiring a bank with an excellent CRA rating. It would also penalize bank holding companies with the highest CRA rating by subjecting them to protracted administrative procedures, including preliminary review, re-review by the Board and public hearing at the end of a two year period, if that bank holding company seeks to acquire a bank with a CRA rating less than 3.

B. The provisions of subsection (7) also permit bank holding companies with a CRA rating of less than 3 to acquire banks under section 3 of the BHC Act, but do not permit these institutions to expand their nonbanking activities under section 4 of the Act. Institutions should be permitted to expand their nonbanking activities if appropriate commitments are made to improve their CRA performance. Many of the approved nonbanking activities, such as mortgage banking, consumer lending, community development, leasing and similar activities, may provide vehicles that would assist a bank holding company in improving its CRA record.

C. In addition, subsection (7) provides that an application by a bank holding company with an imputed CRA rating of less than 3 must be approved by the bank's primary federal regulator in addition to approval by the Board. Currently, these applications are subject to approval by the Board in consultation with the primary federal regulator. Imposing a dual approval process will greatly lengthen the administrative process and increase application costs, without any perceivable benefit.

7. Section 11(c)(1)

A. This section requires the Board to disapprove applications and notices submitted under the BHC Act if the applicant exhibits a pattern of opening or closing deposit facilities, or acquiring or chartering insured depository institutions, in a manner that tends to exclude low- and moderate-income neighborhoods. This provision may require the automatic denial of applications by bank holding companies and banks that devote their resources to commercial banking activities at a single location and do not provide a significant amount of retail banking services to any sector of the community.

These banks and bank holding companies are able to meet their responsibilities under the CRA by providing business credit, in particular small business loans, and by acquiring housing bonds or shares of community development corporations that provide housing and other credit to the community. However, because they limit their banking activities to a single location that is often in a commercial district and provide only limited retail operations, these institutions may be deemed to have established a pattern of refusing to open branch offices in low- and moderate-income areas.

B. This draft of the bill, unlike its predecessor, permits the Board to take safety and soundness issues into account when considering an applicant's record of branch closings. This may not go far enough, however. For example, it is not clear whether a bank or bank holding company would be justified in closing costly or unprofitable branches even before they threaten the safety and soundness of the bank or parent holding company.

Finally, this provision appears to establish an absolute bar to approval of an application involving an institution that has exhibited a pattern of branch closings. This fact would thus supercede factors that the Board must consider under the BHC Act, such as financial, managerial, competitive, and legal factors.

8. Section 11(f)

A. This section defines the imputed CRA rating for bank holding companies. Under this provision, most bank holding companies would receive the CRA rating assigned to the bank subsidiary with the least favorable CRA rating. An exception is made for bank holding companies with five or more depository institutions in a single state. These bank holding companies receive a CRA rating that is one grade higher than the lowest rating of their subsidiary banks, provided that not less than 80 percent of all the bank subsidiaries have a higher CRA rating and that the largest bank in the bank holding company has a higher CRA rating. Bank holding companies with five or more bank subsidiaries in several states also receive a CRA rating that is one grade above the lowest rating received by any of the bank subsidiaries, provided that the bank subsidiaries representing 93 1/2 percent of the assets of the holding company have CRA ratings that are greater than the lowest CRA rating of any of their bank subsidiaries.

It is inherently unfair to attribute the lowest CRA rating received by a multi-bank holding company to the bank holding company. This system penalizes bank holding companies that have a majority of banks with excellent CRA ratings and rewards banks that have an average rating at all of their banks.

B. There is no reason to distinguish between bank holding companies that own several banks in a single state and bank holding companies that own several banks in several states. Our banking system is increasingly becoming national in scope with most states permitting interstate bank acquisitions. Distinguishing between holding companies according to the number of subsidiaries that they own in a single state gives preference to bank holding companies located in unit banking states where bank branching has been prohibited and penalizes bank holding companies located in states where acquisitions are less prevalent because state-wide branching is permitted.

9. Section 11(f)(4)(B)

This section provides an exemption from the imputed rating system for thrifts acquired by bank holding companies in emergency transactions, for banks with a camel rating of 4 or less, and for de novo banks. In each case, the exemption is available only if the acquiring bank holding company submits a plan to the Board, within 90 days following the acquisition of such an institution, that will permit the institution to receive a community reinvestment rating of one or two. Permitting the submission of a plan in these cases following approval and consummation of the transaction is of very little purpose.

10. **Section 11(f)(5)**

This provision would exclude the rating of agricultural banks under $50,000,000 in assets and the rating of all banks with less than $25,000,000 in assets from being taken into account in determining the imputed rating of the parent holding company. This provision would include in the definition of "agricultural bank" any bank that makes 25 percent of its loans in real estate loans in its market area. Consequently, it would define as "agricultural" any bank that meets the 25 percent criteria even if it is located in a major metropolitan area.

11. **Section 11(g)**

This provision requires the Board to publish notice of the submission of an application or notice under the BHC Act "in the manner prescribed in regulations prescribed by the Board as in affect on June 5, 1985." The effect of this provision is to adopt the Board's procedures for requiring newspaper notice in local areas as well as federal register notice for each case involving the acquisition of a bank or the establishment of a nonbanking activity under the BHC Act.

This reference in the statute does not permit the public to be certain of what procedures should be followed for applications and notices submitted under the BHC Act. In addition, it removes all flexibility from the Board in adjusting its procedures to conform to its experience in processing applications and to exengencies that may arise in particular cases.

12. Section 11(h)

This section requires the Board to provide the publ at least forty-five days in which to submit comments regardi any application or notice under the BHC Act. This public comment period would begin following the later of the date th notice is published regarding the application or notice, or t date the Board publishes its weekly bulletin identifying th application or notice. Imposing a forty-five day comment period in every case under section 3 and section 4 of the BH Act would impose costly and arbitrary time delays on the vas majority of applications with no public benefit.

The Board's experience has been that public comment are received in less than five percent of all applications an notices considered by the Board. Where a member of the publi has expressed interest in commenting on an application or notice and provided a reasonable showing that additional tim in which to comment on that application is warranted, the Boa has granted additional time in which to submit comments. Thi procedure permits the Board to grant additional time to commenters in cases where there is a public interest and otherwise to process efficiently the vast majority of cases i which no public comment is expressed.

13. Section 405

Section 405 of Title IV involves amendments to the Community Reinvestment Act of 1977. In particular, this section requires public notice of CRA examinations and establishes a rating system that the federal banking agencies must follow in setting the rating for each financial institution under its supervision.

Section 405 would amend Section 807(a) of the CRA to provide that the Federal depository institutions regulatory agency publish notice of any contemplated CRA the examination on the same day that examination is scheduled to begin. This presents logistical problems for both the federal banking agencies and members of the public that are interested in participating in the examination. First, it is difficult for the Board to coordinate the examination day with the exact day of newspaper publication of notice of the exam, particularly in areas where a daily newspaper is not circulated. Most importantly, publishing notice on the same day that the examination begins does not give the public adequate notice or opportunity to assemble information regarding the institution's CRA performance that may be relevant to the examination.

14. __Section 808__

A. This section establishes a framework for data collection by the banks that requires banks to maintain CRA performance data demonstrating, at a minimum, the amount of resources the institution has committed to housing loans in low and moderate income neighborhoods, small business and small farm loans, as well as financial investments in community development projects in these three areas. The Board is required to place special emphasis on the depository institution's record of serving the credit needs of the community in these three areas in establishing the CRA rating for the institution. The CRA rating is also based on a comparison of the amount of resources devoted in these three areas by the institution with institutions of similar size, with a base rating of average.

This system will entrench housing loans, small business loans, and small farm loans as the perferred, and perhaps only acceptable, means of meeting the CRA requirements of the BHC Act. These data collection requirements coupled with a comparative rating with a base rating of average would effectively require banks to allocate credit in these three areas in amounts that will exceed that amounts devoted in thes three areas by institutions of similar size, in order that the institution may obtain the CRA rating necessary to gain approval to conduct its expansion plans.

This system is undesirable and counter to the public interest. In addition, this system may have the perverse result of encouraging banks not to devote financial resources to legitimate needs of the community in other areas and not to attempt to obtain an above average CRA rating unless the bank has expansion proposals in mind.

This rating system does not permit banks to take into account safety and soundness principles in serving the credit needs of their communities or allow the Board to consider thes principles in evaluating the commitment of resources by a financial institution to loans in these areas.

B. This section of the Bill attempts to make a distinction between large and small banks in imposing this data collection burden. It seems to miss the mark in several respects. The Committee Report makes the assertion that most larger banks "maintain such data on sophisticated computer systems." It is not clear that this is true. Even in those institutions that do have computerized data systems, the data is unlikely to be organized to easily retrieve the data required by this provision or in the format that is to be developed. Further, there will ultimately have to be uniform standards and definitions (e.g., what constitutes a small business loan) imposed to make the data useful in making comparisons. Analysis of data collection costs for the Home Mortgage Disclosure Act suggests that the cost to banks in collecting and maintaining data regarding the geographic location of individual loans is very expensive. For example, HMDA data collection costs about $7 to 9 million.

15. Section 809

This section would require the agencies to make their examination reports and ratings public. Examination reports often contain confidential financial information regarding the company and individuals that should not be made public. Th recommendation contained in Chairman Greenspan's letter to Chairman St Germain of July 21, 1988, for making an assessmer which would include a summary of this information, available the public would accommodate the same interest for public access to CRA performance evaluation information without violating the principles of confidentiality of examination materials.

16. Section 812

This provision requires the agencies to submit annu reports to Congress by March 1 of each year on the data collected under the House Bill. This section also requires reports at 6 month intervals containing, among other things detailed reasons for the number of institutions that had no been examined since the date of enactment and the number of extensions that had been granted. It seems, however, that under this bill these questions are relevant only after two years have passed and only if all institutions have not bee examined. Before two years has passed, the answer to the question regarding extensions will always be "none" and the reason for not having completed some of the examinations wil typically be that they are not yet due to be completed -- th will not be "late" until two years has passed.

17. Section 411

This section would require the establishment by each agency of a division to be known as the "consumer division" and would stipulate specific responsibilities for this division. The charge to all the agencies to "develop proposed regulations to implement all applicable laws relating to consumer protection" is inappropriate given the Board's responsibility for writing rules for Truth in Lending, ECOA, EFTA, HMDA, etc.

This section would prescribe an examination frequency for consumer examinations. Such subjects seem best left to the judgment of the agencies as opposed to being inflexibly codified in a federal statute. Finally, this section permits a holding company to request an examination before the next scheduled application to expedite an application. This provision has the potential to seriously impair the agencies' ability to schedule examinations in an orderly way to meet the bills two year examination frequency requirement. Further, should a large holding company request an examination of some or all of its banks, the request may simply be impossible to accommodate due to resource constraints.

18. Section 106 of Title I

A. There are a number of technical amendments that should be made in other areas of the Bill. For example, section 106 of Title 1 of the Bill establishes expedited procedures for bank holding companies seeking approval to

The **Chairman**. Thank you, Mr. Martin.

Mr. Martin, don't you come originally from Columbus, WI?

Mr. **Martin**. Cincinnati.

The **Chairman**. Cincinnati. Oh, dear, I thought you were a Wisconsin native.

Mr. **Martin**. Fourteen years.

The **Chairman**. Well, nobody is perfect. [Laughter.]

Well, I am delighted that you were with us for 14 years.

And the final witness this morning is Chairman Seidman of the Federal Deposit Insurance Corporation.

Chairman Seidman, go right ahead, sir.

STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, DC

Mr. **Seidman**. Thank you, Mr. Chairman, Senator Garn, Senator Graham. We are pleased to be here. I would start by saying that, in general, we agree with the comments which you just have heard from the other regulators, and we have provided detailed comments in our written statement. I would like to spend my time to make just three fundamental points about this legislation.

MIRAGE CONSUMERISM

First, we believe a good part of the H.R. 5094 really represents mirage consumerism, and that is defined as an effort to correct a problem that doesn't exist. This is so at least as to almost all the banks for which we are the principal regulator.

The Federal Deposit Insurance Corporation is proconsumer and supports the objectives sought through the various provisions of the title. However, we don't believe the title as now constructed will really do much for the consumer.

It will raise the banks' cost of doing business, which consumers—all consumers—ultimately will have to pay. Such a result is not proconsumer; it is anticonsumer.

The new provisions will give rise to multiple and voluminous new implementing regulations and procedural burdens.

Thus, we see significant costs and administrative burdens resulting from these new laws—particularly when taking in the aggregate. Also, keep in mind that on May 27 we dropped this group of new procedures on the banks with respect to prompt payment of checks. So, the small banks are already trying to figure out what these many pages of fine print will do to their operations.

We believe it will raise the banks' cost of doing business.

Given the current record number of failed and problem banks, this is perhaps the worst time in the post-Depression history of banking to heap a multitude of additional expenses upon the industry. This is especially so for smaller banks where the implementation costs of the new provisions could be quite onerous—perhaps to the extent of jeopardizing the safe and sound operation of the weakest institutions.

We also find there is no demonstrated need for most of the additional consumer protection legislation in order to justify such higher costs.

We are also concerned by the impact that requiring a finding on CRA prior to the decision on the rest of the application will have on the processing time frames. Requiring a separate action to be taken solely on the CRA issue will make the process more complex and require additional resources, without expediting the ultimate decision on the application.

Preliminary Approval

The concept of "preliminary approval" is one that will add uncertainty to most transactions. Although many applications receive "conditional approval," such conditions are not open-ended, subject to reversal, and possibly continually changing requirements. Ninety-one percent of all the institutions we examine currently have a "3" CRA rating. The likelihood, then, is that nearly all holding company applications will involve a preliminary approval and, consequently, the public hearing and review processes. In addition to the resource implications, the unwinding of consummated transactions could be disruptive to the institution, and ultimately harmful to the FSLIC and the community.

The continuing enforcement provisions may also increase the uncertainty of the applications process, and decrease the marketability of thrift institutions. Acquirers will perpetually be subject to the penalties of the Act, and to possible unwinding of completed transactions.

Additional Comments

The provisions are applicable only to holding companies, and not to individual acquirers, who may exercise the same amount of control over the insured institution. If these requirements are to be exercised uniformly throughout the industry, they should also be imposed in section 407 of the National Housing Act (12 U.S.C. 1730).

The requirement that an acquirer submit a plan to get the target institution's rating up to the "2", or to maintain the rating at "2", does not make sense for an acquirer seeking a minority percentage of stock that would not enable the acquirer to control the CRA policies of the institution.

Section 405 - Amendments to the Community Reinvestment Act of 1977

Notice of Examination

We support the concept of obtaining greater community input into the examination process. Our new examination procedures direct examiners to conduct interviews with community representatives as part of a regular CRA examination in order to gain a balanced perspective about the credit services the institution under examination and others in the community are providing, and the community's perception of credit needs. Further, we will arrange special interviews with persons who have expressed a desire to discuss an institution's CRA performance or community credit needs. The CRA provides a mechanism for public comment through the CRA public file that both an institution and its regulator are required to maintain, and this information is routinely considered.

For these reasons, we believe that it is unnecessary to require an agency to publish a newspaper notice on the day of commencement of a CRA examination for the purpose of informing the public of its right to submit oral or written comments. Further, providing the notice poses several administrative difficulties, as indicated below.

Since not all towns or cities have a daily newspaper, the proposed notice provision cannot be uniformly applied. Essentially, the notice could be published in accordance with the proposed bill only for institutions located in towns with daily newspapers. The requirements of the bill may be difficult to meet when institutions are located in towns where there is no daily newspaper publication.

In addition, there may be instances where an agency may wish to conduct a separate consumer affairs examination of an institution at the same time it is conducting the traditional safety and soundness examination. In these instances, an announcement to the public that an examination is underway may frustrate the goals of the safety and soundness examination.

For the same reasons expressed above, we also believe that the proposed requirement for regional weekly notices of all examinations commenced may not provide significant public benefit.

Performance Data Collection

We are concerned that what on the surface appears to provide a tool for CRA performance evaluation in fact creates significant new reporting burdens for financial institutions. While paragraph 808(a) requires only that the agencies develop the format for collecting data, the burden of collecting these data would fall on the financial institutions. The result would be a significant multiplication of the effort and cost now expended by institutions under the Home Mortgage Disclosure Act ("HMDA"). We believe that the existing data collection process under HMDA, when accompanied by the regulatory agencies' CRA examination procedures which evaluate many other credit activities, is sufficient to enable the agencies to realistically assess the CRA performance of institutions.

Part of our concern over this proposed addition to the CRA lies in our belief that the data collection categories enumerated do not recognize all of the credit types that may be necessary to help meet the credit needs of a particular community. We believe that data collection for only a limited number of credit categories distorts the relative importance of those categories and presumes, unrealistically, that every community's credit needs will be substantially met by the same few services. However, expanding the list of credit categories subject to data collection is not the answer, since a reasonably complete list of credit categories would result in even a heavier data collection burden for financial institutions.

Written Evaluations

It is customary regulatory practice to provide an institution with a report of findings after the conclusion of an on-site examination and we support the intent of the proposed section of the bill. We are, in fact, considering the possibility of providing the examined institution with the examiner's rating. However, we continue to object to making the examiner's rating and the open section of the report available to the public for a number of reasons. Most importantly, public disclosure of examination findings can be misinterpreted and also have a counter-productive effect on the examination process by damaging the ability of an examiner and an institution's management to have an open and frank dialogue.

Examinations are dependent upon a forthrightness from an institution's management. If either ratings or reports were to be made public, the information gathered by examiners from management during an examination could be less candid. Basically, management may be less inclined to work with the examiner in unearthing the sources of problems. The entire focus of the examination may shift from a concern for substance to a concern about a particular numeric rating.

We are particularly sensitive to the precarious position in which our examiners would be placed by the public release of ratings and examination reports. Examiners would have to defend low ratings to the institution and defend high ratings to the public. Consequently, even with an elaborate rating structure as contemplated by the bill, and the development of even the best internal controls to monitor the implementation of the rating system, it is not unreasonable to expect that ratings and reports may be buffered to some extent to mask particularly critical issues that are likely to raise any outcry. Moreover, we may end up witnessing a "bell-shaped curve" in our ratings distribution, something the bill is seeking to avoid.

Performance Rating System

The concept of a uniform CRA performance rating system developed by all the regulatory agencies is sound and we would support such an endeavor. We believe, however, that public participation by requiring a public notice, comment, and hearing would delay and complicate the process. We have the same concern with regard to the requirement for an annual review of the rating system.

As a more substantive matter, we question the rating system methodology anticipated by the proposed bill. First, the bill mandates that the resulting rating system factor comparable resource commitments from institutions within the same size category. Chairman Wall testified in March that he objected to this primarily because community needs differ and comparisons of how well one institution in an area serves its community as opposed to a similar sized institution serving a different community are impossible to make. We do not see the logic in having a rating system that compares the resource commitment of a rural-based $100 million savings institution with a city-based $100 million savings institution, in either the same or different part of a state or the country.

Second, the rating system methodology also indicates that institutions located in distressed areas where credit needs are more extreme are to be held to equivalent levels of resource commitments as institutions in communities with stronger economies. We believe that to expect this type of comparability cuts against the grain of CRA itself. As part of the CRA assessment factors, an institution's record is measured in light of its ability to meet various credit needs based on its financial condition and size, legal impediments and economic conditions. An institution's record, therefore, should reflect its ability to perform within these constraints.

Activities of Nonbank Subsidiaries

We support the ability of a regulator to consider in the applications process efforts undertaken by nonbank subsidiaries.

Subtitle B -- Agency Reforms

Section 411 - Consumer Divisions

The Bank Board supports the concept of specializing its consumer-related functions and has two established offices to carry out its responsibilities.

Since the 1960s, the Board has had an office with primary responsibility for consumer issues. Then, in the late 1970s, section 18(f) of the Federal Trade Commission Act and Executive Order 12160 mandated the establishment of such offices in all federal agencies and departments. In fact, section 411 of H.R. 5094, which overlaps these existing statutes and orders, appears to be unnecessarily duplicative and may be inconsistent with them.

Within the Bank Board, the Office of Community Investment has responsibility for handling consumer complaints, developing regulations, policies and procedures regarding consumer protection and community reinvestment laws, and preparing relevant annual reports. Last year, we created the Division of Compliance Programs in our Office of Regulatory Activities which has responsibility for placing renewed emphasis on the examination and supervision aspects of consumer matters including the CRA, as well as education of institutions regarding those issues.

The Bank Board has already tried the approach of incorporating the handling of consumer issues within the examination and supervisory processes. After reviewing that experience, the Bank Board decided that activities, except for examination and supervision, related to consumer affairs, civil rights and community investment should be centralized and focused in one office. The Bank Board concluded that these activities required an advocacy which was better performed by a separate office.

We are studying the issue of whether examiners specializing in consumer activities should conduct consumer-related examinations. The traditional Bank Board approach has been that consumer and CRA examinations are conducted as part of safety and soundness examinations. We recognize that utilizing specialists to conduct consumer-related examinations has many advantages and we are, therefore, carefully studying that approach, but a decision has not yet been made. Should this approach be adopted, we would envision that it would mirror the Federal Reserve System's program, which we understand serves as the model for the proposed bill.

The proposed bill requires that consumer examinations be conducted at no greater than 24 month intervals. (By the way, our current cycle is 18 months, well within the 24-month interval.) However, rather than a mandated schedule, we would prefer a frequency schedule that enables us to direct resources to where we need them most - to poorly performing institutions. It makes sense to us to have the flexibility to extend the examination cycle for those institutions that have outstanding performance records in the consumer affairs and community reinvestment areas, so we can shorten the examination cycle for those institutions that have been historically poor performers in these areas. The intention of the flexibility is to "reward" institutions for having excellent records while allowing us, as regulators, to devote our strengths to more vigilant enforcement where it is needed most.

The proposed bill also permits a holding company to request an examination in advance of the next regularly scheduled examination if it determines that the processing of an application might be expedited. Meeting these unexpected demands could prove to be an administrative burden that may undermine the timely completion of the regular examination schedule.

Section 412 - Community Review Boards

We understand the desire of Congress to encourage participation by the public in assessing the performance of the financial regulatory agencies in carrying out their responsibilities under CRA and other consumer protection statutes. We doubt, however, that the Community Review Boards called for under section 412 can achieve the objectives intended by Congress.

The word "community" in reference to the review boards may be a misnomer. Only four representatives from each of four categories are contemplated to provide reviews for an entire Federal Reserve Bank District, an area generally covering a number of states, in many instances an extremely wide and diversified geographic area. Such a group could not be expected to represent all of the local communities spread throughout a district. Since the various federal regulatory agencies have differing regional or district boundaries, establishing review boards according to Federal Reserve Bank districts leaves the other agencies with potentially difficult jurisdictional divisions.

Subtitle C -- Access to Financial Services

Sections 421 through 427

The bill would mandate that each depository institution offer at least one type of basic financial services account that would require no other account relationship with the institution and would impose no prerequisites that might discriminate against low-income individuals. It would also appear to require depository institutions that offer check cashing to provide this service for government checks of $1500 or less to individuals registered for a basic financial services account.

This section of the bill combines two formerly separate sections of the previous draft bill relating to lifeline banking and government check cashing. However, the relationship between the basic financial services account and the government check cashing service is unclear in the current bill.

The Bank Board has always supported voluntary programs to provide such services to the public. For example, the Bank Board, in conjunction with the other agencies on the Federal Financial Institutions Examination Council, firmly supported and adopted a Joint Policy Statement on Basic Financial Services.

Because of its structure and limited powers, the thrift industry would have a very serious problem complying with the Basic Financial Service Accounts required in section 422 of the draft bill. Federal thrifts and some state-chartered institutions, unlike commercial banks, are subject to certain rules which restrict the offering of demand accounts. In fact, the Home Owners Loan Act prescribes that federal associations may only offer demand accounts to persons and entities with whom they have a loan relationship (12 U.S.C. §1464(b)). To all other consumers, they may only offer interest-bearing negotiable orders of withdrawal ("NOW") accounts. Therefore, without specific authorization, thrift institutions would potentially be compelled to provide interest-bearing accounts to satisfy the requirements of the proposed legislation. Federal associations would thus be in the highly inequitable position of incurring far greater costs than other financial institutions in order to fulfill the requirements of this section. We would urge, therefore, that Congress review this provision with an emphasis on the impact it will have on the thrift industry.

With regard to both basic financial accounts and government check cashing provisions, we recommend that the Bank Board, rather than the Federal Reserve Board, be given the authority to prescribe implementing regulations for member institutions.

Subtitle D - Notice of Branch Closure By Bank and Thrift Institutions

Section 433 - Notice Requirements for Thrift Institutions

The provision regarding notice requirements for branch closings would amend the Home Owner's Loan Act, which applies only to federally-chartered institutions. This approach creates a material reporting inequity among institutions based on their type of charter. We believe that this provision should either be dropped or made to apply to all financial institutions.

While the notice requirements under paragraphs (a) and (b) and the reporting requirements under paragraph (c) will be a significant burden upon those institutions required to meet them, this proposed amendment's administrative burden on the Bank Board will be substantially greater. Paragraph (d), entitled "Action Required of Board" is not limited to protested closings, but requires that the Bank Board determine whether a significant reduction of services will result in the community for every branch closing. Where a significant reduction is anticipated, the Bank Board must then (1) consult with leaders of the affected community area, (2) consult with other appropriate depository institutions, and (3) explore the feasibility of replacing the branch with other adequate banking facilities. While we support the intent of these requirements, implementing them in connection with every branch closing would require a tremendous amount of resources. If a branch closing notice provision is to be enacted, we suggest that it be limited to branches located in the low or moderate income areas.

We do appreciate the recognition by Congress that any kind of advance notice provision regarding office closings would have potentially devastating implications for the ability of the FSLIC to act quickly in dealing with deteriorating and insolvent institutions. The subsection entitled "Exception in Case of Emergency Acquisition" addresses part of this situation, but leaves some FSLIC actions unprotected. As we recommended with respect to section 404, any notice provision should include an exemption for both 406 and 408(m) actions.

Subtitle E - Truth in Savings

Sections 441 through 453

The Bank Board has consistently supported the overall objectives of truth in savings. Our current regulations incorporate many of the provisions of sections 443(a) and 444(c) of the House bill. Furthermore, since 1969 the Bank Board has prescribed required disclosures for savings certificate forms.

Subtitle E is substantially similar to Title VI of S.1886, the "Financial Modernization Act of 1988." However, we believe one difference between the House and Senate versions is extremely important, and needs to be addressed. Title VI of the Senate bill is entitled "Truth in Savings and Investments" and contains section 613 - "Review of Disclosure Requirements for Open-End Management Investment Companies." The House bill does not address the issue of non-depository institutions at all.

The coverage of Truth in Savings legislation should not be limited to "depository institutions", but should be expanded to include other institutions that, in the regular course of business, act as financial or investment intermediaries and solicit savings, deposits or investment funds and pay interest or earnings on those funds. Depository institutions compete for funds with many non-depository institutions. Applying Truth in Savings legislative requirements only to depository institutions would be patently unfair, and would be a disservice to consumers attempting to compare solicitations by depository and non-depository institutions.

We note that even the Senate bill leaves the matter to the discretion of the Securities and Exchange Commission (SEC), and only requires regular consultation between the SEC and the Federal Reserve Board. We commend the Senate for recognizing that there is a problem in making these requirements apply only to depository institutions. We urge you to carry this one step further and make the legislation apply evenhandedly to all institutions offering related financial products or services.

At a more technical level, we have no objection to the concept of a uniform annual percentage yield as the primary shopping tool. However, we note this is a change from our existing regulations, which give equal prominence to simple interest and annual percentage yield. Hence, it will necessitate a change in customer expectations. We believe that requiring equal prominence for the annual percentage yield and the annual rate of simple interest would provide adequate disclosure without requiring an abrupt reversal of existing advertising practices.

Subtitle F--Home Equity Loan Requirements

Sections 461 through 467

The Bank Board has demonstrated its commitment to adequate disclosure regarding home equity lines of credit by including such loans in its initial proposal of February 5, 1987 for adjustable-rate mortgage disclosures. Subsequently, many institutions commented on the difficulties inherent in applying the closed-end requirements to open-end loans. Since both the Federal Reserve Board and the Congress had been working on separate home equity requirements, we deferred to these bodies and exempted home equity lines from our final rule.

However, we continue to stand by the principles of our 1987 proposal, which called for comprehensive disclosure, but did not attempt to limit or prescribe contract terms. We do not believe there has been any evidence of abuse that would justify interfering in the normal contractual process.

In our view, the implementation schedule for such a significant provision should be lengthened. This recommendation is based directly on our recent experience working with institutions preparing to comply with the Expedited Funds Availability Act and regulations governing disclosures for adjustable-rate mortgages. For each institution, applying each regulation to its own programs and putting steps into place for implementation takes a considerable amount of time. In addition, the fact that all these regulations are being enacted within a period of 12 to 18 months puts a considerable cumulative administrative burden on financial institutions.

Technical Matters

There are several technical matters which we believe need to be addressed. These will be discussed with your staff.

In the Community Reinvestment Act area, our experience and record shows that banks have complied, to a very significant extent, with existing law. The small number of consumer complaints and protests we have received and few public comments we have found in the banks' CRA public files support this finding.

Thus, we find ourselves in the place of Garrison Keeler reporting from Lake Woe-be-gone that all of the banks are above average.

REQUIRED FINANCIAL SERVICE ACCOUNTS

As to required financial service accounts, the Federal bank regulators have in place a joint policy statement encouraging banks to offer lifeline deposit-related services. A recent survey by the American Bankers Association shows that a majority of banks offer some type of basic banking account. So the market is already moving in this direction.

An edict from Washington in this area is not needed, and every bank's operation simply doesn't fit this kind of operation.

With regard to home equity loan disclosures, the provisions in the bill parallel in many respects the Examination Council's uniform adjustable rate mortgage rule. Thus, we don't believe additional disclosure is necessary.

Second, the provision in the bill requiring each of the Federal banking agencies to create a separate division to handle consumer compliance matters—so-called agency reforms—is unnecessary and potentially very damaging to the efficient operation of the FDIC. Mandating a separate special examination enforcement division will deprive the FDIC the flexibility needed to structure its compliance operations in the most cost effective manner. It will cost us many millions of dollars.

The FDIC currently has an independent Office of Consumer Affairs that combines with our Division of Bank Supervision to form our consumer compliance organization. There is an important interrelationship between consumer compliance and safety and soundness examinations. Both functions in our operation should be managed in a unified and consistent manner.

We acknowledge that in the recent past we were not able to fully meet our consumer compliance goals, due in large part to the historically high increase in bank safety and soundness problems. When the place is on fire, everybody becomes a fireman. But we have taken steps to correct that shortfall.

In 1987, we increased the number of our compliance exams by 97 percent. We expect to increase the examinations by another 60 percent in 1988.

In addition, we have provided enhanced training to our safety and soundness examiners so that they may more effectively supplement the work of the FDIC consumer compliance examination specialists. And, we have decided to designate a consumer compliance coordinator in each of our 94 field offices.

In a word, or two, we believe legislatively mandating a consumer examination division would be unwise, inefficient, counterproductive, and ineffectual; in other words, a really bad idea, especially for the FDIC with its many thousands of small banks to supervise.

Our third point, Mr. Chairman, is that many of the title provisions would place banks in an unfair position vis-a-vis financial service competitors by requiring banks to incur costs not required by their competitors.

The new "truth-in-savings" requirements, for example, would not apply to money market funds where many consumers today have their savings.

If the public is to benefit from additional disclosures, consumers must be able to compare all savings type accounts, not just those offered by banks.

So we prefer the provisions in the Senate bill.

Let me conclude by saying, as you may now suspect, we cannot support this title. In particular, we believe the so-called agency reforms provisions, which would eliminate the flexibility that is essential to an efficient and effective supervisory program, are undesirable.

Micromanagement of the agency and the bank supervisory process by statute surely is a bad precedent to set for future Congresses.

Thank you.

[The complete prepared statement of L. William Seidman follows:]

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

ON

TITLE IV OF H.R. 5094, DEPOSITORY INSTITUTIONS ACT OF 1988

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

10:00 a.m.
September 8, 1988
Room SD-538, Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to offer the views of the Federal Deposit Insurance Corporation on the various consumer-related provisions in Title IV of the Depository Institutions Act of 1988, H.R. 5094 ("Title IV").

Introduction

Title IV would amend several existing banking consumer-related laws and establish a number of new ones. Specifically, the Title would amend substantially the Community Reinvestment Act of 1977 ("CRA"); require each of the federal bank regulatory agencies to establish a separate division to examine and enforce compliance with applicable consumer protection laws; require banks to offer an account for prescribed checking and check-cashing services; and impose notice requirements on the closing of national bank branches. Title IV also includes two bills previously passed by the House of Representatives: the "truth in savings" bill (H.R. 176) and a bill that imposes additional requirements on banks making home equity loans (H.R. 3011).

As discussed below, we are sympathetic to the social objectives sought through the various provisions of Title IV. We have serious concerns, however, that those provisions -- particularly when taken in the aggregate -- might jeopardize the safe-and-sound operation of many smaller banks where the implementation costs of these new provisions could be quite onerous. Further, imposing these additional costs on the banking industry would be especially unfair since bank competitors in the financial services industry would not be subject to the same requirements. Moreover, certain provisions of Title I are, to a significant extent, duplicative of existing -- and largely effec -- federal regulations and procedures.

Furthermore, the "agency reform" provisions of Title IV would eliminate th flexibility that is essential to the efficient and cost-effective operatio of the FDIC, without improving the effectiveness of our compliance supervision. For these reasons -- as elaborated on below -- we cannot sup the provisions of Title IV.

Mandated "Agency Reforms"

Section 411 of Title IV, requiring "agency reforms," would have a disrupti effect on the FDIC's examination and supervisory functions. This section would mandate the creation of a separate "consumer division" in each feder banking agency to oversee the examination and enforcement of consumer-rela laws and regulations, including the CRA. Each new division would be staff with its own corps of consumer compliance examiners charged with conductin separate on-site examinations of insured institutions for compliance with consumer-related laws and regulations.

The FDIC believes the creation of a separate additional examination divisi would prove costly, inefficient and counterproductive, particularly in our agency which supervises thousands of small banks. It would splinter our examination efforts by requiring the establishment of a parallel corps of examiners devoted solely to consumer compliance. Two corps of examiners supervised by separate divisions would be expensive to administer.

It is estimated that the annual overhead costs for salaries, benefits, travel and other administrative items of operating two separate divisions would be at least $1 million more than retaining the consumer compliance examination program in our Division of Bank Supervision. Also, there would be additional significant costs to the banks as a result of the disruption caused by the presence of two separate examination teams in the banks and the potentially diminished effectiveness and success of supervision in both the safety-and-soundness and consumer areas.

There is an important interrelationship between consumer compliance and safety-and-soundness examinations -- with some correlation between banks with safety-and-soundness concerns and those with compliance problems. As a result, it is important that both functions be managed in a unified and consistent manner. Mandating a separate, special examination and enforcement division would deprive the FDIC of the flexibility needed to structure its compliance operations in the most cost-effective manner and would impose a structure that we believe would be ineffectual and inefficient.

The changes Title IV would impose are unnecessary. In December 1986, the FDIC established an independent Office of Consumer Affairs whose director reports directly to the Office of the Chairman. One of the responsibilities of the Office of Consumer Affairs is to monitor independently the progress and effectiveness of our consumer compliance examination and enforcement program and make appropriate recommendations to the FDIC Board of Directors. This office works closely with our Division of Bank Supervision in monitoring the consumer compliance examination program.

In each of the FDIC's eight regional offices, there is at least one Consumer Affairs/Civil Rights Specialist responsible for overseeing the examination program in the respective regions. We also continue to have a small cadre of field examiners who specialize in consumer compliance examinations.

In addition, the Washington Office of our Division of Bank Supervision was reorganized recently. The reorganization included administrative changes in the handling of consumer-related matters. As a result, we are able to provid improved regulatory oversight in the consumer compliance area. These various efforts taken collectively have enhanced substantially the FDIC's ability to discharge its examination and enforcement responsibilities for consumer compliance laws and regulations.

As detailed in our CRA testimony presented to this Committee in March, 1988, in the recent past the FDIC has had to draw examiners away from specialty areas, including consumer compliance, to address the very serious safety-and-soundness problems in the industry. As a result, the number of consumer compliance examinations declined.

The examiner shortfall was attributable not only to the substantially increas number of problem banks, but also to an FDIC policy decision in 1978 to reduc its number of bank examiners. At that time it was thought that our regulator responsibilities could be accomplished with fewer traditional on-site examinations, especially for banks with satisfactory ratings. To supplement our reduced examination efforts, we used increased offsite surveillance, brie visitations, reliance on state regulators where appropriate, and increased market discipline. Although this level of supervision may have been appropriate when the decision to reduce the examiner force was made, conditions changed. Over the past three years we have increased our staff substantially and will continue to do so. In particular, we are dedicated to reestablishing a strong and credible program for consumer compliance examinations and enforcement within our established supervision division.

Despite insufficient staffing and the recent record numbers of bank failures, we have increased the number of consumer compliance examinations and examiner training programs over the past two years. In fact, the number of examinations increased by 97 percent during the past year alone. We expect the number of compliance examinations to increase by approximately another 60 percent in 1988. We have gone to a two-year consumer compliance examination cycle for 1, 2 and 3-rated banks. Four- and 5-rated banks will be examined at least once a year.

We are continuing to evaluate our compliance enforcement program. As a result of this evaluation, we plan to further strengthen our cadre of consumer compliance examination specialists, as well as provide enhanced consumer compliance training to our safety-and-soundness examiners so that they may more effectively supplement the work of the consumer compliance specialists. When this program is fully implemented, we will have a consumer compliance coordinator in each of our field offices -- currently numbering 94 -- in addition to the one or more Consumer Affairs/Civil Rights Specialists now in each of our eight regional offices. These specialists are compliance experts, who will be charged with a continuing responsibility to maintain a compliance enforcement program which is both timely and effective.

In light of this progress and our continuing efforts to improve on that record, we believe a legislatively mandated consumer examination division would be unwarranted and counterproductive. No hearings have been held in the House on this issue. When the structure, costs and benefits of such an approach are thoroughly analyzed, the facts show that the measure is inappropriate especially for the FDIC. Consequently, we urge Congress to reject this effort to manage the examination and enforcement functions within the FDIC.

Amendments to the Community Reinvestment Act of 1977

Title IV of H.R. 5094 would make significant and far-reaching changes in the Community Reinvestment Act -- changes which we believe, for the most part, are unnecessary. Many of the provisions entail significantly increased CRA requirements and accountability in the context of bank holding company applications. We believe that most of those requirements would prove to be costly and counterproductive. However, since those provisions are within the purview of the Federal Reserve Board we will not address them. Instead, we will limit our comments to the other CRA changes contained in the bill.

Written Evaluations. Title IV would require that after each CRA examination the federal banking agencies prepare a written evaluation of, and attach a numerical rating to, the institution's record in meeting the credit needs of its community. Summary CRA assessments are now a part of the public file in connection with applications submitted to the FDIC and are provided to the public upon request. Consumer and community groups can monitor an institution's performance by obtaining the CRA statement, the HMDA-1 forms and HMDA aggregation tables.

The bill also would require public disclosure of a bank's numerical rating. The release of ratings could impair the examination function by:

- Deterring open and frank discussions between a financial institution and its regulator and create an adversarial relationship;

- Adversely effecting institutions that have a compliance problem but are trying to correct it; and

- Causing institutions to use the ratings as a federal endorsement standard in advertising.

The FDIC currently uses numerical examination ratings as an internal method of summarizing a bank's CRA performance, as it does in its safety and soundness supervision. Each bank's rating is a subjective judgment made by the FDIC for supervisory purposes only. Those ratings are not intended to provide banks with a "Good Housekeeping seal of approval."

The federal bank regulators currently release aggregate CRA performance ratings to the public through the Examination Council. The FDIC also provides its ratings and the open section of examination reports to institutions under its supervision.

As an alternative to the provision in Title IV, we suggest that -- in addition to the FDIC's current practice of providing ratings and comments to institutions -- the regulators also prepare a summary assessment, without a rating, which the bank would be required to include in its public CRA file.

It is important that evaluations of a bank's performance focus on a careful summary that cannot be done in a mechanical shorthand, single-digit rating.

Mandated Performance Rating System. Title IV also would require that the federal bank regulators adopt a prescribed numerical CRA-rating system. The ratings would range from "1-excellent" to "5-poor or substantial noncompliance."

The agencies already have a joint CRA assessment rating system that provides a comprehensive, uniform and subjective means for regulatory agencies to evaluate the performance of a financial institution. A copy of an explanation of that system is attached. The current rating system was developed jointly by the agencies through the Examination Council. It was adopted only after the agencies sought, received and carefully considered public comments on the system. Thus, we believe that a statutorily mandated CRA rating system is not necessary. More fundamentally, we question whether a supervisory tool such as a rating system should be legislated or is better left for agency design and revisions as necessary.

The House Banking Committee Report alleges that, under the current CRA rating system, ratings have been inflated because 98 percent of the depository institutions are in the two highest categories of performance. We believe, however, that the reason the aggregate ratings are high is because banks are in substantial compliance with the regulation. The small number of consumer complaints and protests we have received and the few public comments we have found in the banks' CRA public files support this finding.

Because the agencies have a defined uniform rating system already in place, with no evidence that it is inadequate, we see no reason to introduce a new, statutorily mandated CRA rating system. We plan to review that system and consider possible revisions on a continuous basis.

Performance Data Collection. Title IV also would require that the banking agencies develop a joint format for collecting data from depository institutions in connection with CRA examinations. This data would include, in part, low- and moderate-income housing loans, small business and small farm loans, financial investments in local community development projects, and participation in government and private loan insurance programs for housing, small businesses and small farms.

This requirement would impose a serious burden upon regulators and examiners. The burden would carry over to financial institutions as the regulators request them to submit the data. That burden would be particularly onerous if those institutions must develop a data capture and maintenance system in order to have the information readily available.

This provision would require that the prescribed data be collected in a way similar to that under the Home Mortgage Disclosure Act ("HMDA"). HMDA has proven to be very costly and time consuming for the agencies, and the data collected under HMDA have been only moderately useful to consumers. A 1984-1985 survey by the Federal Financial Institutions Examination Council ("Examination Council") of the central depositories on the use of HMDA data showed that approximately 64 percent of the responding depositories said that their HMDA data had been used by the public. The depositories that kept records on the number of data requests reported only one to five requests in two years. The HMDA aggregation project presently costs the agencies approximately $180,000 per year to administer and this cost is predicted to rise considerably next year. The costs of such collections would increase significantly if HMDA is expanded through the "backdoor" -- namely, with the proposed new data collection requirements under the CRA.

There has been no cost-benefit justification for this provision relative to either consumers or to the federal banking agencies. In addition, this data-collection requirement would conflict with the Congressional mandate to reduce the paperwork burden on financial institutions.

Notice of Examination. Section 405 of Title IV would require that the federal banking agencies provide public notice of a CRA examination on the same day the examination begins. The duration of a CRA review is usually only one to three days in smaller banks. Thus, it is unlikely that publication on the date the examination commences would allow for public comments to reach the examiner in time to respond to them during the examination. Also, there are times when examinations must be rescheduled on very short notice.

The present system allows for public comments to reach our CRA examiners. We encourage consumer and community organizations to submit CRA-related comments to the regulatory agencies and banks on an ongoing basis and not only when an examination is about to occur, which may be only once every two years. Our regulations require that each bank maintain a public file of comments on its CRA performance. A bank's CRA file is reviewed by our examiners during the course of an examination. The proposed publication requirement may discourage interim comments, and thus be counterproductive. This would be particularly unfortunate because the existence of public comments is one factor we use in scheduling a CRA examination.

In addition, the regulatory agencies have complaint- and CRA-protest procedures in place that indicate where and to whom consumers may write to comment on an institution's CRA performance. Thus, we believe the CRA publication requirements are unnecessary.

Establishment of Community Review Boards

Section 412 of Title IV would require that each Federal Reserve Bank establish a "Community Review Board" that is heavily weighted with consumer-oriented representatives. The Board of Governors of the Federal Reserve System presently has a 30-member Consumer Advisory Council with a more balanced representation of financial institutions and consumers. The proposed legislation would not only prove costly, but largely duplicative.

The FDIC does not have a consumer advisory council similar to the Federal Reserve Board's; however, we have stepped up our outreach efforts to both consumers and bankers. During 1987 and 1988, we held two sessions with community groups and consumer protection and civil rights organizations in Washington for an exchange of views on community reinvestment and other consumer-related issues. We found these meetings productive and plan to continue such events. We also conduct in various parts of the country compliance seminars where CRA and other consumer-related laws and regulations are addressed.

UNIFORM INTERAGENCY COMMUNITY REINVESTMENT ACT (CRA) ASSESSMENT RATING SYSTEM

Introduction

The purpose of the rating system is to provide a uniform means for regulatory agencies to identify quickly those institutions which require varying degrees of encouragement in helping to meet community credit needs. This provides a comprehensive and uniform system for evaluating the performance of federally regulated financial institutions examined under the various assessment factors of the Community Reinvestment Act and facilitates more uniform and objective CRA ratings.

The rating system ranks financial institutions on a scale from 1 through 5 with a "5" representing the lowest level of performance under the Act and, therefore, the highest degree of concern. Level "3" reflects performance which is less than satisfactory.

This system further employs five "performance categories" or components from which the overall composite CRA rating is derived. The performance categories represent a grouping of the various assessment factors contained in the implementing regulation for the Act. Each performance category is evaluated on a scale of 1 to 5 with a "5" representing the lowest level and therefore the worst performance. As explained later, each performance category includes a narrative description for each rating level.

Overview

Each financial institution is assigned a composite CRA rating that is based upon the institution's performance in meeting various community credit needs. An examiner begins to evaluate the institution's record in meeting community credit needs by first reviewing its financial condition and size, legal impediments, and local economic conditions, including the competitive environment in which it operates. The type of community in which the institution is located will also have a significant bearing on how the institution fulfills its obligations to the community. Community credit needs will often differ with the specific characteristics of each local community, resulting in a variety of ways an institution may meet those needs. To maintain a balanced perspective examiners must carefully consider information provided by both the institution and the community.

Composite Rating

The performance categories are individually assigned a numeric rating. In assigning the overall composite CRA rating, the performance categories will be weighed and evaluated according to how well the institution meets the descriptive characteristics listed below.

Rating (1) — The institutions in this group have a strong record of meeting community credit needs. Both the board of directors and management take an active part in the process and demonstrate an affirmative commitment to the community. Institutions receiving this rating normally rank high in all performance categories. Such institutions have a commendable record and need no further encouragement.

Rating (2) — Institutions in this group have a satisfactory record of helping to meet community credit needs. Institutions receiving this rating normally are ranked in the satisfactory levels of the performance categories. Institutions in this category may require some encouragement to help meet community credit needs.

Rating (3) — Institutions in this group have a less than satisfactory record of helping to meet community credit needs. The board of directors and management have not placed strong emphasis on the credit needs of the community. Institutions receiving this rating have mixed rankings surrounding the mid-range levels of the performance categories. Such institutions require encouragement to help meet community credit needs.

Rating (4) — Institutions in this group have an unsatisfactory record of helping to meet community credit needs. The board of directors and management give inadequate consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank below satisfactory in the majority of the performance categories. Such institutions require strong encouragement to help meet community credit needs.

Rating (5) — Institutions in this group have a substantially inadequate record of helping to meet community credit needs. The board of directors and management appear to give little consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank in the lowest levels of the performance categories. Such institutions require the strongest encouragement to be responsive to community credit needs.

Performance Categories

For purposes of evaluating an institution's CRA performance the various assessment factors and criteria are grouped into the following "performance categories":

I. Community Credit Needs and Marketing
The institution is evaluated in this category on its activities in determining the credit needs of its community and in marketing its services. Included in this category are assessment factors (a), (b) and (c) in addition to how well the institution delineated its community and other technical compliance regarding the posted notice and maintenance of public files.

II. Types of Credit Offered and Extended
The institution is evaluated in this category on the

types and amounts of credit extended to the community and the degree to which those extensions are, in fact, helping to meet the community's needs. Included in this category are assessment factors (i) and (j) plus the institution's CRA statement.

III. Geographic Distribution
The geographic distribution of the institution's loans and any practices meant to discourage applications are considered in this category, as well as the impact of the opening or closing of any offices and the services offered at those facilities. Included in the category are assessment factors (d), (e) and (g).

IV. Discrimination or Other Illegal Credit Practices
The institution's compliance with anti-discrimination and of the credit laws is evaluated in this category. The category includes assessment factor (f). The rating to be assigned here corresponds to the institution's composite compliance rating.

V. Community Development and Other Factors
The institution is evaluated in this category on its participation in community development and/or other factors relating to meeting local credit needs. Included in this category are assessment factors (h), (k) and (l).

Each of the performance categories and the level of performance relating to each category are described in greater detail below.

Performance Category Ratings

I. Community Credit Needs and Marketing
(Assessment Factors (a), (b), (c) and Community Delineation)

Rating Level 1 — The institution has actively undertaken steps to determine community credit needs. These activities may include:

- Identifying the demographic makeup (racial/ethnic groups and low- and moderate-income areas) of its community and making meaningful contacts with a reasonably full range of organizations (civil, religious, neighborhood, minority, etc.) to assist in determining the credit needs of all segments of its community;
- Taking into consideration comments to the public file which describe existing unmet credit needs; and
- Contacting local government officials to identify any needs of private lender participation in existing or prospective community development or redevelopment programs. (In rural areas the local government body may be the county supervisor's office or other appropriate office.)

The institution has actively undertaken marketing and credit related programs appropriate to the size and capacity of the institution and the nature and location of the community. These programs should reach all segments of its community. Community segments should include low- and moderate-income residents, small businesses and, where applicable, owners of small farms. Management has also established working relationships with real estate brokers and others who serve low- and moderate-income areas and who may provide assistance for small or minority businesses. There is evidence that senior management is aware of community concerns and activities.

Rating Level 2 — The institution has undertaken activities to determine its community's credit needs. As a result of these activities, the institution is generally aware of the credit needs within its community, including low- and moderate-income areas. The institution has initiated a dialogue with community representatives such as local government, neighborhood, religious, and minority organizations, or small business and small farm organizations. The institution has undertaken marketing and credit related programs but the programs are not ongoing or comprehensive. Senior management demonstrates an awareness of community concerns and activities.

Rating Level 3 — The institution's activities to determine community credit needs are limited. The institution's employees may serve as volunteers on community organization boards and committees. However, the institution has notestablished a systematic method to determine how or if its employees' volunteerism assists the institution in meeting its CRA goals. The institution's advertising may be principally deposit oriented. In addition, the institution generally has made no efforts to market its services on an equal basis to all segments of its community. Marketing and credit related programs do not include a mechanism for reaching low- and moderate-income areas within the delineated community. The institution's marketing effort does not adequately focus on marketing the types of credit for which the institution has identified a need (or a need is otherwise apparent). There may also be some concern about the community delineation.

Rating Level 4 — The institution's efforts to determine community credit needs are very limited and fail to address major segments of its community. Management has not established a dialogue with organizations representative of the community, including any which represent low- and moderate-income or minority neighborhoods within the delineated community. The institution's marketing and credit related programs are limited or poorly conceived. There may also be some concern about the community delineation. Senior management is unaware of special needs of low- and moderate-income residents, small business and small farms.

Rating Level 5 — The institution has not undertaken any meaningful efforts to determine community credit needs. Management has limited knowledge regarding the community's demographic characteristics. The institution's marketing and credit related programs are either non-existent or have repeatedly excluded low- and moderate-income areas within the delineated community. There may also be some concern about the community delineation.

II. Types of Credit Offered and Extended

(Assessment Factors (i), and (j) and CRA Statement)

Rating Level 1 — The institution has investigated the need for different types of credit within its community such as residential mortgage loans, housing rehabilitation and home improvement loan, and small business or farm loans, including the need for private, as well as government-insured, guaranteed, or subsidized forms of such loans. It has then made an explicit effort to assure that its loan policies are responsive to the needs and has examined the extent to which it and other institutions within the community are meeting the need for such loans. The institution's CRA statement lists the types of loans found to be needed in the community. The involvement by the institution in the making of each type of loan listed in the statement demonstrates an affirmative effort to make such loans and to do its share in meeting existing needs, consistent with its resources and capabilities.

Rating Level 2 — The institution's CRA statement and loan portfolio indicate that it has investigated the need for residential mortgage loans, housing improvement/rehabilitation loans, small business and farm loans, and private, as well as government-insured, guaranteed, or subsidized forms of such loans within its community. It has made an explicit effort to assure that its loan policies are responsive to the needs found. The institution's performance in this category is distinguished from a 1-rated institution primarily in the extent to which it is marketing the availability of loans and/or in the degree to which the types and volume of loans being made match the community's most pressing credit needs.

Rating Level 3 — The institution may not be offering one or more types of credit listed in its CRA statement, despite a capacity to do so. The institution's loan portfolio and other sources, including peer analysis, may indicate that the institution's share of loans of a type or types identified as needed in the community, including any low- and moderate-income areas, is marginal or somewhat below average, particularly with respect to extensions for residential housing, small business or farm credit.

Rating Level 4 — The institution's record of offering and of making loans reveals that it is doing relatively little to help meet known or demonstrated credit needs for residential, small business or small farm credit, particularly for residents of low- and moderate-income areas. Its participation in private as well as government insured, guaranteed or subsidy loan programs is either prefunctory or nonexistent, under circumstances where the need for such loans has been identified and the lender can articulate no objective supportable reason for its low level of participation.

Rating Level 5 — The institution is unwilling to adapt its credit offerings to serve demonstrated unmet credit needs in its community, particularly for housing, small business or small farm credit. This rating would be particularly appropriate where the lender's failure to meet these needs was cited in a previous examination.

III. Geographic Distribution

(Assessment Factors (d), (e) and (g))

Rating Level 1 — The geographic distribution of the institution's credit extensions, applications and denials indicate that the institution is making the substantial portion of its credit available to all areas within its community. The institution has reviewed the geographic distribution of its credit extensions, applications and denials in a manner appropriate to the size and capacity of the institution and the nature and location of the community. Where that review has disclosed a very low level of applications from or loans to a particular neighborhood or area, especially low- or moderate-income areas, the institution has reviewed its marketing practices to determine what, if any, impact they may have had on the distribution. Where appropriate, the institution has either revised its marketing practices or lending policies or both. The institution's officers are reasonably accessible to all segments of its community and banking hours are tailored to meet the convenience and the needs of its customers. Finally, the institution considers, in advance, the potential impact of opening and closing offices on its ability to continue offering reasonably equal services throughout its community.

Rating Level 2 — The geographic distribution of the institution's credit extensions, applications and denials indicate that the lender is making credit available to all areas within its community. The institution has taken steps to eliminate unreasonable lending patterns disclosed by examiners or which have resulted from the review of the institution's policies or practices. The geographic distribution of applications reveals no pattern suggestive of any practice of discouraging or "prescreening" applications. The institution's record of opening and closing offices and the provision of services at its offices do not reflect any disparate treatment of minority or low- and moderate-income neighborhoods. Offices are reasonably accessible to all segments of its delineated community. Services and banking hours are periodically reviewed to assure accommodation of all segments of the delineated community.

Rating Level 3 — The geographic distribution of the institution's credit extensions, applications and denials may suggest unreasonable lending patterns. Management has not attempted to review its lending policies and procedures or to analyze the institution's lending patterns within its community. The institution's record of opening and closing offices and its provision for services at its offices may indicate a disparity of treatment between certain areas within its community. Such a disparity is isolated and not an overall intentional pattern or practice. Management has plans to undertake immediate steps to restore reasonably equal service to any affected areas.

Rating Level 4 — The geographic distribution of credit extensions, applications and denials reveal unreasonable lending patterns, particularly in low- and moderate-income neighborhoods or areas of racial/ethnic concentration. The geographic distribution of applications may indicate a possible pattern or practice of discouraging or illegally prescreening applications. The institution's record of opening and closing offices and the provisions of services at its offices may suggest a pattern of disparate treatment of minority or low- and moderate-income neighborhoods. The record might portray an institution that has systematically sought to close or curtail services at offices serving minority or less affluent neighborhoods while opening new offices in developing, majority or upper-income areas.

Rating Level 5 — The geographic distribution of credit extensions, applications and denials reveals extensive, systematic, and unreasonable lending patterns. The institution has adopted loan policies and procedures, such as unjustifiably high minimum mortgage amounts or down payments or restrictions based on the age of property, which have or can reasonably be expected to have a significantly adverse impact on loan availability in low- and moderate-income or minority neighborhoods. The institution's record of opening and closing offices and the provision of services at its offices suggest a continuing pattern of disparate treatment of minority or low- and moderate-income neighborhoods. Where this was previously cited, management has not taken any corrective action.

IV. Discrimination or Other Illegal Credit Practices (Assessment Factor (f))

The rating to be assigned here corresponds to the institution's composite compliance rating.

Rating Level 1 — The institution is in substantial compliance with antidiscrimination and other credit laws.

Rating Level 2 — The institution is in satisfactory compliance with antidiscrimination and other credit laws.

Rating Level 3 — The institution is in less than satisfactory compliance with antidiscrimination and other credit laws.

Rating Level 4 — The institution has an unsatisfactory record of compliance with antidiscrimination and other credit laws.

Rating Level 5 — The institution is in substantial noncompliance with antidiscrimination and other credit laws.

V. Community Development and Other Factors (Assessment Factors (h), (k) and (l))

Rating Level 1 — The institution has taken affirmative steps to become aware of the full range of community development and redevelopment programs within its community. It is actively participating in the development or implementation of such programs to an extent consistent with its size and capacity and the nature and location of the community. In non-MSAs, the institution has contacted appropriate government and non-government representatives to determine the level of community development needs in its area. It has then determined what areas are appropriate for its involvement and has initiated such involvement or has undertaken other types of activities not previously covered, which in the examiner's judgment reasonably bear upon the extent to which the institution is meeting the community credit needs.

Rating Level 2 — The institution is aware of community development/redevelopment programs within its community. It has advised appropriate community officials of its interest in participating in such programs and is already involved in some aspects of program planning or implementation. Or, the institution is planning to undertake a specific activity designed to help meet community credit needs, which has not been covered in other categories, within six months.

Rating Level 3 — The institution is only vaguely aware of the community development/redevelopment activities in its community. The institution has taken little affirmative action to become involved in community development or to learn the specific features of different programs. Management appears receptive to becoming involved or investing in one or more programs but prefers to wait for a request to be initiated by community officials. At such time, the institution will consider possible participation. Management has periodically discussed various efforts to respond to community credit needs but a specific plan has not been developed.

Rating Level 4 — Management is unaware of the existence or nature of community development programs within its community and has expressed no interest in pursuing this area. Management has not developed any other programs, which were not covered previously, to help meet community credit needs. Management may be unaware of the CRA regulations' encouragement of institution involvement in community development redevelopment programs.

Rating Level 5 — Management has repeatedly demonstrated its lack of interest in determining if community developments projects exist in its community. It has not expressed an interest in developing its own response to community credit needs.

Financial Services Account

Section 422 of Title IV would require banks to establish a "Basic Financial Services Account" that includes a transaction component permitting up to ten withdrawals per month and a government check-cashing feature. We generally favor efforts to encourage the offering of such "life-line" services. In November, 1986, the FDIC joined the other federal bank regulators in adopting the Examination Council's "Joint Policy Statement on Basic Financial Services." A copy of that statement is attached.

The policy statement is in place and appears to be successful. A new America Bankers Association survey shows that 52 percent of all banks -- and 70 percent of those with assets of $1 billion or more -- offer some type of basi banking account. This is up from 44 percent one year ago. Thus, although we favor the furnishing of "life-line accounts," given the banking industry's current adherence to the regulators' policy statement, legislation seems unnecessary.

With regard to government check cashing, we continue to question the extent problems in this area. Our records do not indicate a significant number of complaints or inquiries concerning government check cashing. We believe the registration process necessary to establish the customer account would be a paperwork burden on institutions, adding to the costs ultimately passed on t consumers.

Truth in Savings and the Home Equity Loan Requirements

The FDIC supports clear and uniform disclosures in connection with the making of bank loans and the offering of deposit products. However, we are concerned that the "truth-in-savings" and home-equity-loan requirements -- when layered on top of the other provisions in Title IV -- would impose significant and, for many banks, unmanageable new burdens on the industry.

If "truth-in-savings" legislation is to be enacted, it should apply to all financial entities, including investment companies. Many consumers today have their savings in money-market funds, rather than banking institutions. If the public is to benefit from disclosures of the cost and terms of savings accounts, consumers must be able to compare all savings-type accounts, not just those offered by financial institutions. We therefore prefer S. 1507 to its counterpart in Title IV. In addition, we believe a standardized method of calculating interest, as proposed in the Senate bill, would make disclosures less confusing and voluminous.

With regard to the home-equity-loan disclosures, this bill parallels in many respects the requirements of the FDIC's uniform adjustable rate mortgage rule. Although we endorse the objective of providing consumers with pertinent disclosures, additional disclosures may be unnecessarily confusing for consumers and unduly costly to banks.

Equal Credit Opportunity Act Amendments

Section 481 of Title IV would amend the Equal Credit Opportunity Act ("ECOA") to specifically subject business and commercial loans to the recordkeeping requirements and adverse action notices imposed under ECOA. We are concerned about the additional recordkeeping and administrative burdens this provision would impose upon the industry. At a minimum, we suggest that small banks be exempted from this requirement. In addition, a provision in Title VIII of H.R. 5094 would amend the ECOA to ensure that credit is not denied to individuals on the basis of any course of study pursued. Our records do not reveal a problem in this area. Therefore, we question the necessity of the provision.

Other Provisions

CRA Exception for Failed and Failing Banks. Section 403 of Title IV would prohibit the Federal Reserve Board from approving certain applications by bank holding companies unless -- with specified exceptions -- the bank holding company has an "imputed community reinvestment rating" of "2" or better under the prescribed rating system. One specific exclusion from the general rule would apply to banks acquired by bank holding companies under Section 13(f) of the Federal Deposit Insurance Act ("Act").

Section 13(f) involves only FDIC-assisted emergency *interstate* acquisitions. We prefer that this exclusion be broadened to clarify that not only banks acquired under Section 13(f) of the Act, but all failed or failing banks acquired by bank holding companies through transactions under Section 13(c) of the Act, would be excluded from a bank holding company's "imputed rating." This suggested amendment would be consistent with the objective of affording relaxed CRA treatment to transactions involving failed and failing banks.

Branch Closing Exception for Failed and Failing Banks. Section 432 of Title IV would require national banks that propose to close a branch to provide notice of the proposed closing to the Comptroller of the Currency within specified time periods. We defer to the Comptroller as to his substantive comments on this provision. But -- similar to our immediately preceding comment on Section 403 of the Title -- we request that the specified exceptions to the branch closing notification requirement in the Title be expanded to include all failed and failing bank situations. We also request that "bridge banks," which are national banks organized by the FDIC to operate closed banks until they can be sold, also be excluded.

Conclusion

In conclusion, we believe that Title IV of H.R. 5094 would impose unreasonable and costly new burdens on financial institutions and regulators at a time when safety-and-soundness pressures are of particular concern. Thus, we cannot support the provisions in Title IV. In particular, we believe the "agency reforms" would eliminate the flexibility that is essential to an efficient and effective supervisory program. We acknowledge the need for improvement in our consumer compliance operations. However, we have taken steps to bolster our programs.

We recognize the positive social objectives of Title IV. However, we are concerned about the effect those provisions in the aggregate would have on the banking industry and the consumer who would ultimately bear the costs. Moreover, these requirements would not apply to banks' financial services competitors. This inconsistent treatment of financial service providers would be unfair and anti-competitive.

Additionally, there has been no major review or study of the cost, burdens, and benefits of the proposed consumer laws or the numerous consumer protection laws enacted over the past 20 years. We urge the appropriate committees of the Congress to provide for such reviews, especially with respect to the cumulative impact of the various laws on the financial institutions industry and the general public. Pending the completion of such a study, we urge a moratorium on further broad new initiatives in the consumer protection area such as those contained in Title IV.

Thank you Mr. Chairman and members of the Committee, for giving the FDIC an opportunity to express our views on these issues. We will be pleased to respond to any questions.

Attachments

Federal Financial Institutions Examination Council

1776 G Street NW Suite 701 · Washington DC 20006

Joint Policy Statement on Basic Financial Services

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, National Credit Union Administration, Office of the Comptroller of the Currency, Conference of State Bank Supervisors, National Association of State Credit Union Supervisors, and National Association of State Savings and Loan Supervisors are issuing this joint policy statement to encourage the efforts of trade associations and individual depository institutions regarding the offering of "basic financial services." 1/

The economic environment in which financial institutions operate has changed over the past few years, due in part to increased competition from outside the traditional depository institution structure, increased cost of funds following deregulation of interest rates, and interest rate volatility. As a consequence, many institutions have had to adopt new strategies to market their services, generate income, manage risk, and reduce costs. Some institutions have begun to explicitly price their products, consolidate or eliminate services they believe to be unprofitable, and close branch offices. In many instances, institutions have increased service charges, imposed new fees, and raised minimum balance requirements.

1/ The Comptroller of the Currency previously issued a banking circular on this subject to all national banks in August 1985.

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Home Loan Bank
National Credit Union Administration, Office of the Comptroller of the Currency

While such adaptation may be a necessary response to competitive markets, considerable concern has developed about the potential impact of these changes in effectively denying or reducing convenient access of many individuals to the payments system and to safe depositories for small savings. Because credit availability is often dependent on an account relationship with a financial institution, access to credit for low-income or young consumers may also be adversely affected.

While a significant number of consumers have never had a deposit account, some research studies reflect declines in account ownership that may be cause for concern. For example, between 1977 and 1983 the proportion of families headed by a younger person having checking accounts decreased, as did the number of families from the lowest income group, regardless of age. The proportion of young families having either a savings or a checking account also declined. While the cause of these declines is not always clear, the surveys do suggest that a significant number of individuals or families do not have a deposit relationship of any kind.

Legislation dealing with basic financial services has been introduced at both the federal and state level as a result of these concerns. The industry has also responded. Many financial institutions have independently undertaken to develop and implement new measures to meet minimum consumer needs. They are offering basic services, such as low-cost transaction and savings accounts with low or no minimum balances, accounts for consumers who use a limited number of checks or drafts, and other accounts on which minimal charges are made for account maintenance. Institutions that have for years

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The CHAIRMAN. Thank you very much, Chairman Seidman.

Governor Johnson, under the Senate and House banking bills, banks would be precluded from equity underwriting unless there is an affirmative vote of the Congress at some later time, and of course that provision is only in the Senate bill. The House just precludes it entirely.

If there is no legislation this year, could the Fed by regulation allow equity underwriting by bank holding companies?

Mr. JOHNSON. Well, of course we would have to have an application for that by the banking community, but under the provisions of the Glass-Steagall Act we certainly could consider that, and of course we have full securities underwriting activities under study within the limitations of section 20 of the Glass-Steagall Act. But of course it would be possible.

The CHAIRMAN. To what extent would that be, in your judgment, feasible?

Mr. JOHNSON. Well, of course I can't speak for every Board member, since it would require full consideration of the seven-member board. But since, as you know, we support the Senate bill and have made it clear that we do support full securities underwriting, preferably through legislation, we would more than likely look favorably on securities underwriting activities as constrained by section 20. But that would be full equity underwriting as well.

The CHAIRMAN. Let me ask you another question, Governor Johnson.

DELAY IN ESTABLISHING SECURITIES SUBSIDIARIES

According to an ABA Commission analysis, the House bill would delay the ability of bank holding companies from establishing securities subsidiaries by as much as 2 years. This stems from the rulemaking process required for adopting new CRA rating standards and from the subsequent exams.

Do you agree that there would be such a delay if the House passes its bill in its present form?

Mr. JOHNSON. Yes, I do. I think the provisions in title IV of the House bill are extremely onerous in terms of the application process.

There is a 45-day comment period that only begins after examinations have taken place and after the applicant has had to undertake newspaper advertising in various local communities. In some cases this may mean a prolonged period before the comment period could even start. Then there is the 45-day public comment period, and then beyond that there is the possibility of extensions on comments. Once that process has been finished and the application has been reviewed and decided, there is still a follow-up process for certain cases which could extend easily into a 2-year period before everything is final.

It is an extremely burdensome process and also has the possibility of being retroactive in nature. It is a very unfortunate set of provisions.

The CHAIRMAN. Chairman Seidman, you say the following on page 1 of your prepared testimony, and I am reading it now:

We are sympathetic to the social objectives sought through the various provisions of title IV. We have serious concerns, however, that those provisions, particularly when taken in the aggregate, might jeopardize the safe and sound operation of many smaller banks where the implementation costs of these new provisions could be quite onerous.

Speaking hypothetically, what if we did not agree to the provisions of title IV in the aggregate but we did agree that some of them in the interest of getting agreement on a larger bill?

In that case, which provisions of title IV would you recommend we accept?

Mr. SEIDMAN. Well, that is a difficult question, Mr. Chairman. Certainly, the CRA provisions are very costly, as the Federal Reserve's Governor Johnson has pointed out, and those are certainly among the most onerous. I guess if looking at it from a bank cost, those would be the ones that we would like to see restricted.

I think the truth-in-savings and home equity bills are already taken care of. However, if they are implemented, they will be very costly.

The CHAIRMAN. Thank you, sir.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Governor Johnson, as you know, in the House bill there are provisions that amend the Equal Credit Opportunity Act. In particular, under the House amendment the authority of the Federal Reserve to exempt transactions from requirements of that act would be restricted.

EXEMPTIONS FROM CERTAIN EQUAL CREDIT OPPORTUNITY ACT REQUIREMENTS

I understand that the Federal Reserve currently exempts business creditors from certain Equal Credit Opportunity Act requirements.

Why were these exemptions adopted to begin with?

Mr. JOHNSON. First of all, the Board did not exempt business credit transactions from any of the substantive requirements prohibiting discrimination on the basis of race, sex, marital status etc. The only exemptions are from procedural requirements having to do with notices, recordkeeping and the like. One of the reasons why these limited exemptions were adopted is that there are certain characteristics associated with business credit practices that would create special burdens on financial institutions that are extending credit to businesses. In certain cases—for instance, trade financing, which goes on all the time and requires continuous transactions—it could easily generate serious burdens if institutions are required to provide notices of equal opportunity and access to a report every time that transaction took place.

There are hundreds of those and they continue constantly. The exceptions are aimed at dealing with that particular issue of excessive paperwork and they are aimed at dealing with large business transactions that might take place as well.

Of course we support the notion of the right to credit information and borrowers should be entitled to the reasons for why they have been rejected for credit. However, we think there are specific potential problems associated with notifying a borrower of their rights every time a transaction takes place, especially in the business credit area, because of things like trade financing and special large transactions.

But in general we certainly support the equal credit opportunity legislation and its purposes, and business borrowers like consumers are protected by the law and the Board's regulations from discrimination.

Senator **Garn**. This is what I wanted you to bring out because that is why it was exempted to begin with. Sometimes there can be several of these commercial transactions in a day. They are phone conversations. They are people that know each other, that have had relationships for years, letters of credit, all sorts of things.

It gets to be a little bit ridiculous to notify you when you and I know each other. We have only been working together for 7 or 8 years, know each other on a first name basis, but I have got to supply you with all of this paperwork.

Mr. **Johnson**. As I indicated, the exemptions only apply to the notification of their rights in terms of receiving a report on why they have been rejected and certain other procedural matters. They do not apply to the other substantive features. We have never really had exemptions for those.

Senator **Garn**. And I just wonder if the House of Representatives lives in some different world than the Senate of the United States. As we get more and more into these hearings, I think that maybe we should be like the Nebraska Legislature—have a unicameral legislative body—and solve a lot of problems.

Mr. Martin, the CRA provisions in the House Banking Committee's bill do not apply—and you mentioned this in your testimony in general—to cash management accounts, mutual funds, insurance companies, and other competitors of depository institutions.

Can you give me any justification why if we were going to apply these onerous provisions they shouldn't be applied onerously to these other competitors as well?

Mr. **Martin**. You are talking about the cash checking, and so forth?

Senator **Garn**. Yes.

Mr. **Martin**. OK. If you can just bear with me here a minute.

Senator **Garn**. Well, CRA actually.

Mr. **Martin**. There basically, first of all, are some problems that—as you know, we have joined—first of all, let me backtrack—we have joined with the other agencies in a policy statement on the basic financial services. We support a voluntary program to provide services for the public.

The mandatory lifeline services which are being proposed will put the Federal thrifts and some of the State charters at a disadvantage because they legally can offer demand accounts only to those who have loan relationships with them. They would be forced to offer interest bearing NOW accounts to other unknown customers.

Senator **Garn**. Mr. Clarke, CRA provisions of the House Banking Committee bill require a rating of banks on a scale of 1 to 5 relative to other banks. This contrasts with the rating system based on the standard for CRA performance.

As I mentioned in my opening statement, doesn't a rating system like that sort of guarantee that you get put in the old bell curve? Some of them you just simply have to say are not performing because they are not doing as well as some others; they are still doing a good job but you may get half of them on the bottom of that bell curve?

Mr. **Clarke**. Senator, that is exactly right, and I have made that point in my written statement.

I think it is important to keep in mind that the mandate of the Community Reinvestment Act is that banks help meet the credit needs of their community—not do it better than their competitor—but help meet the credit needs of their community. Some are obviously going to do it better than others, because being human, people do some things better than others. The point of the exercise, however, is whether the bank is helping meet the credit needs of the community.

Senator **Garn**. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn.

The Senator from Florida.

Senator **Graham**. Thank you, Mr. Chairman.

I would like to ask two lines of questions, first on bank services.

We have had testimony at previous hearings which indicates that there has been a declining proportion of the American people utilizing the banking system.

DECLINE IN NUMBER OF FAMILIES USING THE BANKING SYSTEM

Mr. Johnson, I wonder if that statement coincides with information available to the Federal Reserve System and, if so, what is the explanation for that declining percentage of American families using the banking system?

Mr. **Johnson**. I think that that is certainly true for certain groups with certain sociodemographic characteristics. I am not sure that is true as a whole, but I am aware that it is in selected situations.

I think that what our research tends to indicate is that in many instances it has to do with urbanization and sociodemographic characteristics of the population and that as the demographic trends cause a certain element of the population to be represented in larger proportion they are traditionally those groups that utilize banking services less often than other demographic groups, and so the trend, the demographic trend, leads to an increase in nonutilization of certain banking services.

Senator **Graham**. Assuming that it is a desirable social goal to have maximum participation by American families in the banking system with the benefits that bring to the family economic security, do you have any recommendations in addition to or in modification of the bank service provisions that are in title IV of this House act to accomplish the goal of increasing the number of American families participating in the system?

Mr. **Johnson**. Yes. Well, we certainly cannot support the provision in title IV on basic banking which requires basic banking services to be extended by all banking institutions at fixed rates. We have constantly resisted the notion of a specific requirement at a fixed price.

However, we, the Federal Reserve Board and the other regulatory agencies here, have combined to issue a policy statement encouraging the banking system on a voluntary basis to extend certain types of lifeline or basic banking services to certain disadvantaged groups, but in a flexible way so that they can design the program to meet the special needs of the community and be able to recover what costs are associated with that.

And as Chairman Seidman indicated earlier, surveys which have been conducted indicate that voluntary extension of basic banking services is succeeding. Some suggest that over 50 percent of banking organizations now provide some form of basic banking services, and that trend seems to be continuing.

Of course, I think technologically we are getting to a point where through direct deposit types of technologies and electronic funds transfer there is the possibility of making Government checks directly available through direct deposit in banks. This could, I think, give greater access to individuals for certain types of banking services and check cashing privileges, or at least the ability to have their money directly deposited and withdrawn in cash form.

So all of these trends are useful, and we have certainly encouraged basic banking, but on a voluntary basis.

Senator GRAHAM. Mr. Chairman, I see the yellow light is on. I would like to ask a question on the CRA. So to conclude with the banking services questions, I might reserve the right to submit some written questions to each of the members of the panel to pursue further what is occurring under the voluntary program that has just been described by Mr. Johnson.

On the CRA it seems to me that there is a basic conflict in the way in which the obligation has been defined, and I think it has been defined fairly uniformly by each of the four panelists, and that is that the current law contains an obligation to essentially educate the community as to banking services and, second, it requires that the institutions operate in a nondiscriminatory manner within the bounds of safety and soundness principles.

That second statement is where I see the conflict because operating within safety and soundness is inherently discriminatory. It is not invidious, but it is discriminatory because you are trying to determine who is a sound credit risk and who is not a sound credit risk, and that is an act of discriminatory judgment, and so the real issue is how to assure that judgments are being made based on objective principles and not socially unacceptable standards of discrimination.

There have been a number of individual cases brought to the attention of the committee, some of which were referred to in the statement by Senator Riegle. At our hearing that we held on March 23, there were a number of witnesses who testified about what they thought were invidious discriminations, and in the course of the hearing I asked Ms. Martha Seger, who was representing the Federal Reserve at that time, for some further information as to how the Fed in its analysis made the distinction between process and performance, and Ms. Seger in a subsequent letter dated May 24 stated:

As I stated in my testimony, I believe our examinations involve looking at both; that is, both process and performance. However, it is not our policy to require banks to make particular kinds of loans or specified amounts in a given area in some relationship to the demographic makeup of that area. That, in my opinion, would be a form of credit allocation, which the Board has long held is properly a legislative function rather than a function of this or any other agency to take upon itself.

Looking at some of the specific examples, such as those in the Atlanta Journal series and the Detroit Free Press series alluded to by Senator Riegle, if you are familiar with those individual cases, how do you evaluate them in terms of the apparent moving across the line from objective standards of safety and soundness into discriminatory actions based on socially unacceptable standards of discrimination?

Mr. JOHNSON. Yes, Senator. First, we still have under study the Detroit situation, and so I don't feel like I can comment on that until we have completed our study as to verification of the facts and conclusions.

On the Atlanta study, we have looked into that to a significant degree, and we have communicated with this Committee in terms of our findings. It is a very complicated situation. Our study supported the statistical facts, as noted in the Atlanta Journal & Constitution study, that there does appear to be a significantly lower number of mortgage loans made in certain minority areas relative to other areas.

However, it is not clear to us at all that this is a result of discrimination. We have carefully looked at the data and there seem to be a number of factors that muddy the waters considerably on this issue.

One is that even though home purchase mortgage lending is relatively lower in minority census tracts, it is not true of home improvement lending. As a matter of fact, home improvement lending has been higher in minority census tracts than in the other census tracts, and so it is hard to understand why creditors would extend above average amounts of credit for home improvement lending and below average on mortgage lending.

Second, there are some statistical differences. Even though the study tried to look at middle income census tracts of roughly equal income levels, the actual median or mean income level in the minority census tracts was still below the average and median income of the other census tracks. Discrepancies in the average income in those census tracts could make a difference. It is not clear how significant that would be, but certainly a difference.

There was also a different level of demand in the two census tracts. For instance, the number of home sales, which is somewhat a proxy for the level of demand or the rate of demand in census tracts, was considerably lower in the minority census tracts than in the other census tracts, and that could account for some of the differences in the amount of mortgage lending in a relative sense.

So we could not confirm that there was actual discrimination or redlining in the mortgage lending process because there were some statistical differences between the two comparisons, for example, in looking at home improvement lending. Even there you have to be careful because there are different types of home improvement loans.

As I said, we have not completed the Detroit assessment, and we would be happy to communicate our findings when we do.

But of course if we determine that in fact the differences are due to discrimination and can't be explained by these statistical issues, we certainly would feel compelled to seek strong compliance.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Sasser.

Senator GRAHAM. I would be interested in receiving your—the Detroit study when it's completed. I'm certain Senator Riegle, based on his statement, would likewise.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

OPPOSITION TO PUBLIC DISCLOSURE OF CRA RATINGS

Mr. Seidman, in your testimony, you oppose public disclosure of the Community Reinvestment Act ratings because you indicate, and I quote, "institutions would use the ratings as a Federal endorsement in advertising," close quote.

Well, now the question comes:

Why is that bad? In other words, we see banks advertising all the time they're members of the Federal Deposit Insurance Corporation. They wear that as a badge of honor. And in this day and time, it's good for business to say you're a member of the FDIC.

Banks are advertising that they're home-owned, home-operated to serve home folks needs. They advertise that they're a community bank.

And it occurs to me that, if they are advertising using their rating with the Community Reinvestment Act as participation in their community, it could almost be called a badge of honor and I and a lot of other people might like to be a customer of a bank that had a good record in the community.

What's wrong with advertising?

Mr. SEIDMAN. Our principal concern is that we have a numerical rating system and they're going to advertise that rating. That can change based on what they're doing month to month. It's an inexact science and it would give the impression that the Government can accurately rate these institutions.

If we had a pass/fail system, which is in essence what we have suggested—in other words, the Government passes a law and says you act in this way and, if they do, they pass—then we would have no objection.

And we have suggested that a statement be provided for the public of how the bank is, in fact, operating its community relations.

So our key difficulty with a kind of seal of approval is the rating system that goes with it.

Senator SASSER. What if you had a three-tier rating system? Just good, fair and flunk? Would that serve the purpose?

Mr. SEIDMAN. Well, that's a three point system instead of a five-point system so it's two points better.

But, my own feeling is that the Government is telling the banks to behave in a certain way. If they behave in that way, they ought to be so certified but, if they don't, then they have failed the test.

That seems to me to be a much more equitable way to deal with the situation and make it possible then to have a seal of approval.

Senator SASSER. Now, Governor Johnson, I understand that, from your answer to Senator Garn's question, that you feel the extension of the Equal Credit Opportunity Act to business credit is unnecessary.

Is that correct?

Mr. JOHNSON. Well, OK——

Senator SASSER. Let me sharpen that question just a little bit.

Mr. JOHNSON. OK.

Senator SASSER. And say: What if we just extend the Equal Credit Opportunity Act to small business loans?

I mean, the Equal Credit Opportunity Act is designed obviously to correct what some perceive to be a gender imbalance or gender discrimination. And with no ceiling on it, the ECOA would apply equally to General Motors Corp. or a mom and pop store down at the end of the block selling candy or something.

It appears to me that it's really intended to apply to small business because that's where you find women going into business for themselves in the business community.

And what if you put a limitation, a lid on it and said it doesn't apply above a certain number.

What would be your reaction to that?

Mr. JOHNSON. I think that that would be constructive in terms of having some sort of cap limit to the size of the transaction which would require notices and record keeping.

Many business credit practices are somewhat negotiated, and that can make a difference in the need for format notice of rights. And at the same time, there is this concern about the large number of transactions in certain types of business relationships like trade financing.

But let me emphasize that most of the Equal Credit Opportunity Act applies equally to the business community. Small-business persons and small-business entities are now entitled under the law to a full report on why they may have been rejected for credit.

Assuming certain exceptions, I see no harm in the extension of the procedural provisions to business credit.

But there are special cases I think that make a difference in the business area versus the personal, individual area.

Senator SASSER. Gentlemen, my time is about up. I want to ask one question though.

The House has passed a bill that's chocked full of proconsumer provisions. The Proxmire bill that we passed over here is leaner in that regard. We don't have the extensive provisions that are in the House bill.

It's been my experience that when the House and Senate go to conference and one has extensive provisions and the other has very slim provisions, that the one with the slim provisions ends up taking—adding a lot to their bill that came from the other side.

Now, as briefly as possible, I'd like to have each of you set out what you think are the proconsumer provisions of the House bill that would have the least effect on the safety and soundness of our banks.

I frankly think that safety and soundness in this environment we're operating should be the overriding criteria in looking at these provisions.

Who wants to take a crack at that?

Mr. SEIDMAN. I'll start, Senator.

I think, and I say this through clinched teeth, that as far as what's going on, if you mandate that we have a separate division for compliance that will have the least effect on safety and soundness. As I said, however, I don't think it's an effective way to run the Government.

But, nevertheless, I don't think it will impinge on safety and soundness.

I guess in your first question, Mr. Chairman, you were asking me what will we compromise on, to some extent. I could say that it is not a safety and soundness provision and would have really very little effect on that.

Almost all the other ones to some extent impose additional costs on the banks. And the CRA provisions particularly, where there are credit allocation implications, I think would be the worst in that regard.

Senator SASSER. Thank you.

The CHAIRMAN. Gentlemen, I just have a very, very—one overall question and I think it's an important question because we're in a——

Senator SASSER. Mr. Chairman.

The CHAIRMAN. I beg your pardon.

Senator SASSER. I beg your pardon. I know my time has expired, but I wanted to get one or two more of these panel members.

The CHAIRMAN. Fine. I thought you were through.

Senator SASSER. This may be useful information to you, Mr. Chairman, when you do battle with the House conferees.

The CHAIRMAN. And when you join us in battle and lead the charge.

Senator SASSER. All right. [Laughter.]

I was counting on you leading the charge, Mr. Chairman. [Laughter.]

The CHAIRMAN. I take up the rear. That's where the admirals always stand. [Laughter.]

Senator SASSER. Do you want to address that, Mr. Clarke?

Mr. CLARKE. I would just like to make an observation, Senator. We have a lot of confidence in Chairman Proxmire and you and the other members of this committee who may be participating in that conference not to let that balance get out of alignment. I realize that there's a temptation when you don't have as extensive a consumer section in your bill to accede to some of the things the House has recommended. I hope you won't do that because, in my judgment, title IV as a whole should not be supported.

Senator SASSER. Well, which one's will have the least impact on safety and soundness?

SAFETY AND SOUNDNESS OF INSTITUTIONS

Mr. CLARKE. To get to your question of what would have the least impact on the safety and soundness of institutions, that would the disclosure provisions already incorporated in the Senate bill with respect to home equity lending and truth-in-savings. We probably would also not have any particular objection to requiring that banks provide some kind of notice of branch closings. We've already encouraged banks to do that voluntarily. But I think it ought to stop there. That should be a business decision made by the financial institution itself.

Mr. MARTIN. We would agree with Mr. Clarke in his analysis of which two provisions are most acceptable. One is the truth-in-savings. And the other is the home equity disclosure.

And the simple reason for this choice is that we already have ample regulations covering these areas. But I do want to reiterate that the proposal on truth-in-savings does not leave us with a level playing field.

The people that would have to comply with the truth-in-savings requirements are the banks and the savings and loans, but mutual funds and any other nondepository institution would not have to comply with it.

Mr. JOHNSON. Senator, I would second the other panel members on that. I think those are the two major proconsumer issues that do not raise the safety and soundness issue—the disclosure provisions on home equity and truth-in-savings.

And of course I would add our recommendation from the Federal Reserve on how to improve CRA without going the title IV approach.

Senator SASSER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Sasser.

On August 31, figures were released, as they are every year, on the distribution of income in this country by income category. And they were shocking.

The upper 40 percent received on the basis of the information we have the highest proportion of income ever on record. They got 67 percent of the income for all Americans.

The lowest 40 percent got the lowest that any—the lowest 40 percent has ever received: 15 percent.

Now that's part of what we're in. We're also into a situation here where our financial institutions have the greatest challenge to safety and soundness they've had, certainly in the 31 years I've been on this committee.

Not only the savings and loans but the banks. We know the terrific problem you have. We have a recession that's going to be much worse. You have to be very careful about safety and soundness.

Now we try to reconcile this kind of situation. I think the House has a very good point. And I think you gentlemen concede that there's a point here in doing what we can to be sure that the allocation of deposits that come out of poor communities is fair.

The data we have here shows that banks and savings and loans return an estimated 9 cents of each dollar deposited by blacks in home loans to black neighborhoods. That's all home loans, including new housing and including rehabilitated housing.

They return 15 cents of each dollar deposited by whites in home loans to white neighborhoods. I'm talking about Atlanta, but there's no reason why Atlanta should be much different. And I think the situation in Milwaukee is about the same and it's likely to be about the same elsewhere.

Now with that in mind, both the fact that we have a very serious, the most serious, I'd say, savings and safety and soundness problem we've ever had, and a problem of maldistribution of income, I would like to ask the other three regulators to comment on Governor Johnson's proposed alternative to House CRA provisions.

And as I understand it, those CRA provisions that you have, Governor Johnson, more disclosure of CRA assessments and opportunities for consumer groups to comment.

Mr. JOHNSON. Yes. I might add that, by that, I don't mean that we would support actually publishing the CRA numerical ratings from the examinations.

We would consider the actual rating number confidential, but we would have an evaluation, an assessment of the——

The CHAIRMAN. Well, I hope you would make that as comprehensive as possible. You see, the trouble is that, as Senator Riegle pointed out, about 99 percent are passed.

Mr. JOHNSON. I understand, Mr. Chairman.

The CHAIRMAN. And there's only a tiny proportion that get a failing grade.

Mr. JOHNSON. Yes.

The CHAIRMAN. Despite the fact that there's an enormous difference in that 99 percent.

Mr. JOHNSON. It would be a comprehensive evaluation not just simply publishing the number itself, but clearly pointing out any deficiencies that existed from the examinations that we undertook.

The CHAIRMAN. Mr. Seidman.

GOVERNOR JOHNSON'S PROPOSED ALTERNATIVES

Mr. SEIDMAN. Mr. Chairman, we've suggested something very close to that in our testimony: not that we publish, but that we make available to the public a summary which gives the public a good opportunity to understand how this bank is——

The CHAIRMAN. And to comment.

Mr. SEIDMAN. And to comment. We haven't said they can do it, but they can comment at any time to us. We would have no objection to permitting public comment.

The CHAIRMAN. Mr. Martin.

Mr. MARTIN. We're opposed to publishing either the rating or publishing the result of the examination.

The CHAIRMAN. Well, what's left of CRA if you do that. Isn't disclosure the implementing principle? What good does it do if you can't get focused the public attention on it and inform the community what's happening to the money they deposit?

Mr. MARTIN. Well, I believe, Senator, that through the examination process we surface particular issues of concern in institutions. Once these concerns are identified, we will see that the institutions correct them.

The CHAIRMAN. But you're against disclosure?

Mr. MARTIN. Yes.

The CHAIRMAN. Mr. Clarke.

Mr. CLARKE. Mr. Chairman, we are against disclosure, too, let me explain.

Under the statute as you designed it and as it was passed, there is an opportunity at all times for community groups to comment on the extent to which a bank is helping meet the credit needs of its community. Those comments can be directed to the bank. If they are directed to the bank, they are required to be put in the bank's public file, which is accessible to anybody. Comments can also be directed to the bank's supervisor. The submission of such information to a bank supervisor can be a triggering device to cause the supervisor to go into a bank and take a look. Newspaper articles like the ones which have appeared in Atlanta and Detroit also represent input from the community to the supervisors. I just don't see the need to have something that is published after the fact when there is opportunity for consumer groups or anyone else to comment ahead of time on how well they think a bank is meeting the credit needs of its community.

The CHAIRMAN. What bothers me is that—I have great respect for all you gentlemen and I think you do a fine job. It seems to me we should have some discipline on the regulators.

Regulators are inclined to be friendly and favorable and supportive of the people they regulate. Disclosure is a cleansing, disciplining force here.

We found that there were many banks that didn't realize that they could lend to blacks, they could lend to low-income ethnic neighborhoods, as long as they loaned on the basis of a sound structure and a good credit rating.

If they did that, their record was every bit as good as it was in the suburbs, in the places that were all white and where incomes were higher.

But, there's an apparent and unfortunate prejudice in cities such as Atlanta and Detroit. Some banks go the easy way and stay out of the black neighborhoods. They may not draw an actual red line but it amounts to that.

That's what we have to overcome. I think the House has a legitimate position. If we're going to get legislation, it seems to me we have to get some kind of principle here that compromises, it doesn't do damage to the safety and soundness—serious damage—but also provides an opportunity for people with modest and low incomes, people who are black, the minorities, to get a fair rate.

Mr. CLARKE. The problem, Mr. Chairman, is the way in which a consumer or CRA rating would be perceived. It would be perceived differently by banks and community groups. Disclosure of such a rating could lead to the kinds of hazards that I disussed in my written statement. That is——

The CHAIRMAN. In order to get a better rating, the banks would make bad loans?

Mr. CLARKE. Yes.

The CHAIRMAN. Did you ever know of any example of that?

Maybe you're right, but——

Mr. CLARKE. I'm very concerned that that is the effect disclosure of CRA ratings would have.

Community investment is a partnership among banks, the community and bank supervisors. Bank supervisors are just one part of offered such services to particular groups of customers are now advertising their availability more widely. Other institutions are exploring and finding ways to maintain a physical presence in low- and moderate-income neighborhoods even while reducing the expense normally associated with full branch facilities. Trade groups too have joined in these efforts to encourage the offering of such services at affordable prices. The American Bankers Association and Consumer Bankers Association, for example, have called upon their members to address the continuing interest in basic banking services.

The member agencies of the Federal Financial Institutions Examination Council and the associations of state supervisors wish to encourage such efforts by trade associations and individual depository institutions that promote the offering of basic financial services, consistent with safe and sound business practices. While the specific type of services will, of course, vary because of differences in local needs and in the characteristics of individual institutions, we encourage efforts to meet certain minimum needs of all consumers, in particular:

- the need for a safe and accessible place to keep money;
- the need for a way to obtain cash (including, for example, the cashing of government checks);
- the need for a way to make third party payments.

We believe that industry trade associations have a key role to play in this effort, and are in a position to encourage a constructive response without the rigidities of legislation or regulation. We realize that some associations have such programs already underway.

These programs could usefully:

1. Encourage members to offer and appropriately publicize low-cost basic financial services such as those listed above.
2. Survey the current availability of such services among member institutions.
3. Make available to members not providing such services material reflecting the successful experiences of other organizations.

that triumvirate—the part charged with the responsibility of assessing the extent to which banks are meeting the credit needs of their community.

We can't do that in a vacuum. We need to have input from community groups. But when we go into banks, very seldom do we find any information in the public file of that bank that indicates that the bank either is or is not helping to meet the credit needs of the community. That indicates to me that one of the three partners is falling down on the job, because if they believe a bank is not meeting the credit needs of the community, they ought to be providing information to the bank, or to the bank supervisors.

The CHAIRMAN. Thank you, gentlemen, very much. You've been excellent witnesses and provided a good record.

Now we have a panel of distinguished people representing the banking and savings and loan industry. Tomorrow, we'll have consumers.

Mr. Carruthers, Mr. Culpepper, Mr. Kolesar, Mr. Rideout, and Mr. Sullivan.

Gentlemen, we'll start off with Mr. Carruthers. Mr. Carruthers is president of the Citizens Bank of Clovis, in New Mexico. He is representing, as I understand it, the Independent Bankers Association of America.

Mr. Carruthers, we're delighted to have you.

STATEMENT OF KENT CARRUTHERS, PRESIDENT, THE CITIZENS BANK OF CLOVIS, CLOVIS, NM

Mr. CARRUTHERS. Mr. Chairman and members of the committee, I appreciate the opportunity to present the serious concerns that community bankers have about the consumer provisions of title IV of H.R. 5094.

Before addressing those issues, I'd like to thank you, Mr. Chairman, for your very strong letter to the Fed in support of regulations on nonbank banks.

We are disappointed that the Fed has chosen not to adopt the strongest possible regulation. As you know, the IBAA strongly opposes the provision in the House bill which delays a 7-percent growth cap for 2 years. We hope the Senate will rectify that bad situation.

Mr. Chairman, there are two provisions of title IV which are supported by community bankers. We support the House passed Home Equity bill but would prefer some streamlining of the disclosure provisions.

CREDIT UNIONS EXEMPTED

We are dismayed that the Senate bill exempted credit unions from specific parts of this bill. Community bankers strongly support the technical amendments to the Expedited Funds Availability Act, although we are adamantly opposed to the provisions in the House bill that give special treatment to credit union payable through drafts.

We strongly oppose the remaining provisions of title IV. Much of the title is based on the premise that banks are essentially public utilities which should provide congressionally mandated banking services at set prices.

Unfortunately, this premise does not differentiate between large banks, which would not be allowed to fail, and thousands of community banks which fall outside the public utility support system.

As presently drafted, the basic banking account and the Government check-cashing service required in the House bill fail to address the needs of the un-bank consumer population.

If the policy goal of the Congress is to address the banking needs of those individuals who do not presently have bank accounts requiring a check cashing service does not solve the problem.

The IBAA is opposed to Congress mandating a government designed bank account. Many banks already offer their own version of a basic banking account on a voluntary basis.

The terms, conditions, and costs of these accounts are determined by the bank to meet the needs of the local customers.

The bill gives depository institutions the authority to close these accounts on only two conditions. One, consistent overdrafts and, two, a pattern of fraudulent activity.

We strongly protest the Government requiring banks to tolerate a pattern of fraud. Any single instance of fraud should be reason enough to close an account.

The Government check cashing provisions in title IV is an improvement over earlier proposals, but it still has a number of serious deficiencies.

SOME SERIOUS DEFICIENCIES

First, it does not establish a true account relationship between the bank and the customer. An account relationship, even a lifeline or basic account, provides the bank and the consumer with the opportunity to develop a banking relationship.

Second, the bill sets a statutory maximum fee of $2 per check and fails to address the cost of the bank in cashing government checks.

Third, the bill does not adequately address the increased risk for fraud that banks would face in cashing all government checks.

The best way to address the fraud problem is to require that customers—consumers receive their government checks by direct deposit into our bank account. Direct deposit is a reasonable compromise between the concerns of the banking industry and those of the consumer.

It would provide the consumer with same day availability for withdrawal, eliminate the possibility of lost or stolen checks and greatly reduce the risk of fraud to the bank.

Title IV also contains a massive expansion of CRA, which we believe would be at the expense of safety and soundness.

By their very nature, community banks have been meeting the credit needs of their trade area for years, long before the enactment of CRA.

The CRA provisions were somewhat improved during the House Banking Committee markup by exempting banks under $25 million in assets or agricultural banks under $50 million.

Title IV imposes stringent new burdens on banks and bank holding companies but does not touch the operations of nonbank banks, securities firms, insurance companies and other companies which also provide financial services.

These other companies take deposits oftentimes taking the funds out of the community. These firms may provide some local credit, but they completely escape the requirements of CRA.

The House bill calls for a massive reorganization of the Bank regulatory agencies and the hiring of many new Examiners to exclusively examine for compliance with consumer regulations. The human resources of the agencies have already been strained by the increased numbers of failed and troubled banks.

Title IV also comes uncomfortably close to establishing a credit allocation scheme by directing the agencies to emphasize three specific types of credit; a financial institution's responsibility is to meet its community credit needs, which may or may not be included in those elaborated in the bill.

Finally, we are opposed to the public disclosure by the agencies of the banks' CRA rating and evaluation. The information could be used negatively to impair the safety and soundness of the institution or to hold the institution hostage to unreasonable demands.

While we hope that any legislation passed this year will not include these onerous CRA changes, we strongly urge the consideration of higher exemption levels for small banks and agriculture banks with an annual inflation adjustment built into any such provision.

As you know, the Funds Availability Act just took effect last week requiring banks to comply with over 650 pages of regulation. Title IV would add six new consumer protection laws and hundreds of pages of regulation.

Add to that the enhanced enforcement powers of regulators and a possible credit card disclosure bill.

Community banks will be swamped with new regulations. By their very nature, community banks serve the deposit and credit needs of their communities. Their success is directly dependent on the health and well-being of their hometowns.

I urge you to keep in mind the unique role of community banks as you consider these issues.

Thank you, Mr. Chairman.

[The complete prepared statement of Kent Carruthers follows:]

ATTACHMENT #1

THE CITIZENS BANK OF CLOVIS

Conveniently located at the following addresses:

421 Pile Street **Main & Commerce Way** **21st & Prince Street**

also

North Plains Mall **Texico** **Fort Sumner**

Our 24 hour MONEY ATM machine is located at 21st & Prince Street, offering drive-up banking at your time, all year long!

THE CITIZENS BANK OF CLOVIS
SERVICE CHARGE AND FEE SCHEDULE

REGULAR CHECKING ACCOUNT-PERSONAL

Average Daily Balance	Charge
$500 or Over	No Charge
$400 - 499	$3.00
$300 - 399	$4.00
$ 0 - 299	$5.00

Accounts receiving a service charge will be charged 20¢ for each check exceeding 25 in one cycle.

Overdraft protection tied to Southwest Card Services issued MasterCard or Visa: Fee is $5.00 or 1% of the cash advance, whichever is greater.

Business accounts are service charged on an analysis basis. See bank for complete details.

ECONO CHECKING-PERSONAL

A monthly fee of $2.00, for the first 12 checks; 50¢ for each additional check written during cycle. No balance requirement.

Availability of funds is determined by origin of deposited item(s). Current availability schedule and bank policy will govern. See bank for details.

NEGOTIABLE ORDER OF WITHDRAWAL ACCOUNT "NOW ACCOUNT"

Personal (Non-Business)

Minimum required balance: $500.00

$500.00 and over	No Charge
Below $500.00	$6.00 per month plus 20¢ per check

Interest earned on the average daily collected balance, payable on cycle date.

Rates can change every Tuesday, potential rate differential for larger accounts. 500 - 2,499; 2,500 - 9,999; and 10,000 - over

Business

Interest earned on the average daily collected balance, payable on cycle date.

Regardless of balance, a service charge of 15¢ per check, 25¢ each deposit and $3.00 each item charged back. If statement balance falls below $3,000.00 at any time during the monthly cycle, preceeding charges plus maintenance fee of $10.00.

MMDA - MONEY MARKET DEPOSIT ACCOUNT

Interest can change every Tuesday, Compounded daily, Interest earned on the average daily collected balance, payable on cycle date. Three withdrawals and three drafts allowed per month. Should withdrawals exceed the maximum number, the bank may either close account or take away accounts' transfer and draft capacities. Unlimited transactions at bank.

Should balance fall to below $2,500 but above $500, interest will be paid at "NOW ACCOUNT" rate for cycle period. Below $500 at any time during cycle period, account will be charged $6.00 maintenance fee plus 20¢ per check.

SAVINGS ACCOUNT

Interest compounded daily, minimum balance to open is $100.00. Interest paid if account earns 40¢ or more per month. $1.00 per month charge on accounts with less than $100.00. Two withdrawals per monthly cycle period, withdrawals in excess of two will be charged $1.00 each.

Dormant Account Status: A demand deposit account will become dormant after 180 days without customer generated activity. A $10.00 charge will be assessed when account goes dormant plus a $1.00 per month fee regardless of balance.

A Time Account (savings) becomes dormant after three years of no customer generated activity. A $10.00 charge will be assessed when account goes dormant plus a $1.00 per month fee regardless of balance. All dormant accounts turned over to the state after statutory time period.

TESTIMONY

of

KENT CARRUTHERS

PRESIDENT OF

THE CITIZENS BANK OF CLOVIS

CLOVIS, NEW MEXICO

ON BEHALF OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

ON

TITLE IV - CONSUMER PROTECTION PROVISIONS OF H.R. 5094

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

THURSDAY, SEPTEMBER 8, 1988

ROOM 538 DIRKSEN SENATE OFFICE BUILDING

WASHINGTON, D.C.

Mr. Chairman and members of the Committee, my name is Kent Carruthers. I am President of The Citizens Bank of Clovis, in Clovis, New Mexico, and I am appearing this morning on behalf of the Independent Bankers Association of America. The IBAA is the only national trade association that exclusively represents the interests of independent community banks.

I appreciate the opportunity to present the serious concerns community bankers have about the various consumer provisions in Title IV of H.R.5094. My background provides me with a well-rounded perspective on these issues. My experience as a bank officer over the past ten years includes two and half years as a bank compliance officer. In addition, I was a commissioned national bank examiner for the Comptroller of the Currency for several years.

Before addressing the consumer issues, I'd like to thank you, Mr. Chairman, for your very strong letter to the Federal Reserve Board in support of the regulations on nonbank banks. As you know, the IBAA strongly opposes the provision in the House bill which delays the 7% growth cap for two years. We hope the Senate will kill that bad idea. At a time when Congress is considering putting all new bank powers except those very closely related to banking in the bank holding company structure because of safety and soundness concerns, grandfathered nonbank banks should not be encouraged to continue circumventing the Bank Holding Company Act.

Our major concern about Title IV was best stated by Fed Chairman Alan Greenspan in a letter to Congressman Wylie, the ranking minority member of the House Banking Committee. Chairman Greenspan wrote: "Coming so soon after the major regulatory burden imposed by the Expedited Funds Availability Act, this title, taken as a whole, will constitute a massive new burden on the banking system, particularly on smaller banks without the resources to handle these regulatory requirements."

Mr. Chairman, first I would like to focus on the consumer provisions of the bill supported by community bankers. We support the House-passed home equity bill. We would prefer some streamlining of these provisions to be able to provide our customers with a simpler and more understandable disclosure. We are dismayed that the Senate bill exempted credit unions from specific parts of this bill. Credit unions have been very active in home equity lending and deserve no special-interest exception. As consumers, credit union customers are entitled to the same disclosures. Why should credit union customers not be able to receive the same information they would receive under the same circumstances from a bank?

Community bankers strongly support the technical amendments, included in the Senate and House bills, to the Expedited Funds Availability Act. That law, which went into effect last week, will provide ideal opportunities for check-kiters and others to take advantage of the system. The technical changes will help protect institutions from fraud. Again, we are adamantly opposed to the provision in the House bill that gives special treatment to credit union payable-through share drafts. The success of funds availablity is tied to the expedited processing of checks. Credit unions utilizing nonlocal payable-through banks and benefiting from remote disbursement nevertheless want their items to be treated as local. As it is now, we cannot rely on our automated systems to process these share drafts. We urge the Senate either to mandate the use of local payable-through banks by credit unions or to permit the industry to handle these items by where they are processed, that is, look to the location of the payable-through bank.

The truth in savings legislation is troublesome because it requires a laundry list of disclosures inappropriate for advertisements. We are very concerned about the average daily balance calculation required by the Senate bill and the credit union exemption. We support the requirement that the Federal Reserve and the SEC work together to insure that consumers receive adequate disclosures about mutual funds. It is our understanding the SEC has recently taken steps to require more complete disclosure by the mutual fund industry. The Senate should urge the SEC to continue its efforts.

We strongly oppose the remaining provisions of Title IV. Much of the title is based on the premise that banks are essentially public utilities, which should provide Congressionally-mandated banking services at set prices. Unfortunately, this premise does not differentiate between large urban banks and thousands of community banks.

We, like Congress, recognize that large financial institutions will not be allowed to fail. But community banks are different; we fall outside the "public utility" support system. We operate under the discipline of the free market system and are allowed to fail. Some 150 banks have failed so far in 1988, matching the disturbing 1987 pace. We ask you to keep this in mind as you consider these onerous consumer provisions. Imposing public-utility-like requirements on community banks will simply increase our costs and further reduce our profit margins. Our only market base is our local community. We must serve it well to survive and prosper.

Let me turn now to some specific comments on the three parts of Title IV which concern us the most: 1) the "basic" banking account; 2) the government check cashing service; and 3) the changes in the Community Reinvestment Act (CRA).

As presently drafted the basic banking account and the government check cashing service required in the House bill fail to address the needs of the "unbanked" consumer population. If the policy goal of Congress is to address the banking needs of those individuals who do not presently have a bank account, mandating a check cashing service does not solve this problem. Those unbanked individuals will remain outside the mainstream of the banking services. Congress should be seeking ways to bring this unbanked population voluntarily into the banking system.

The IBAA is opposed to the government mandating all banks to offer a government-designed bank account. Many banks already offer their own version of basic banking account on a voluntary basis. The terms, conditions and costs, if any, of these accounts are determined by the bank to meet the interests and demands of its local customers. In November 1986 my bank created our version of basic banking with an "Econo Checking-Personal Account." We set no minimum balance, established a monthly fee of $2.00 for the first twelve checks and charge 50¢ for each additional check written during the cycle. The House bill would eliminate a bank's ability to establish an account as we did. It would write account terms and conditions into federal law with the fees and charges set by the Federal Reserve Board. This is certainly an excellent example of government interference with the market. (attachment #1)

Presently of our 7400 DDA accounts only 35 utilize our basic banking account. All our new account representatives know about the account and all our new account literature describes it. We just have not had much interest in it. There is no guarantee a government-designed account would meet with greater success than our Econo Checking account has.

There are several other very specific problems with the House bill on basic banking. The bill only gives depository institutions the authority to close the basic banking account on two conditions: 1) consistent overdrafts; and 2) a pattern of fraudulent activity involving the account. Mr Chairman, we strongly protest the government requiring banks to tolerate a "pattern" of fraud. Any single instance of fraud should be more than sufficient reason to close an account. A pattern of suspected fraudulent activity should also be sufficient reason to close an account. Why would Congress even consider requiring a bank to expose itself to a pattern of fraud? This contradicts the basic tenets of safety and soundness.

Mr. Chairman, the government check cashing provision in Title IV is an improvement over earlier proposals, however, it still has a number of serious deficiencies. First, it does not establish a true account relationship between the bank and the consumer. Indeed, the bill provides that the bank cannot require other account relationships. An account relationship, even a "lifeline" or basic account, provides the bank and the consumer with the opportunity to develop a banking relationship. Second, the bill sets a statutory maximum fee of $2 per check and fails to address the costs to the bank in cashing government checks. This $2 fee would not cover the costs of the additional bank personnel needed or the expenses in having larger volumes of cash on hand. Third, the bill does not adequately address the increased risk of fraud that banks would face in cashing all government checks.

In November 1986, my bank began cashing government checks for noncustomers for a $2.00 fee. We presently cash approximately 100 checks per month. My losses over the last 12 months were $1212 from five checks. In each instance, fraud was the reason for the loss. The bank's income from the check cashing is about $1.00 per check, net of losses, but this does not account for the costs associated with check processing or any overhead costs. So you can see the $2.00 fee is a bare minimum charge which does not effectively cover our actual costs. (attachment #2)

The best way to address the fraud problem is to require that the consumers receive their government checks by direct deposit into an account at the bank. Direct deposit is a reasonable compromise between the concerns of the banking industry and those of the consumer. It would provide the consumer with same-day availability for withdrawal on the designated day, eliminate the possibility of the check being lost or stolen and greatly reduce the risk of fraud to the bank. It is a safe and reliable means to deliver a consumer their money. Furthermore, it establishes an account relationship for the consumer. If there are significant numbers of "unbanked" consumers, we believe Congress should seek ways to encourage the establishment of banking relationships.

Title IV also contains a massive expansion of CRA which we believe would be at the expense of safety and soundness. CRA is based on the premise that banks have an affirmative obligation to help meet the credit needs of the communities in which they are located. By their very nature, community banks support this premise and have been meeting the credit needs of their communities for years, long before the enactment of the CRA.

Mr. Chairman, I must acknowledge that the CRA provisions were somewhat improved during the House Banking Committee markup. There are two specific exemptions for banks under $25 million in assets or agricultural banks under $50 million: (1) their holding companies are exempt from the new restrictions on applications for nonbanking activities under the Bank Holding Company Act; and (2) the new recordkeeping requirements for these small banks are less extensive. We had strongly promoted a higher exemption level for community banks.

Title IV imposes significant new burdens on banks and bank holding companies, but does not touch the operations of nonbank banks, securities firms, insurance companies and other companies which also provide financial services. These other companies take deposits, oftentimes taking the funds out of the communities. These firms may provide some local credit, but they completely escape the existing CRA requirements and onerous new CRA requirements.

Currently CRA activity focuses primarily on bank acquisitions and branch applications. The House bill would greatly expand CRA review to cover almost every application affecting a bank's business activities. For example, the onerous CRA review process would apply to the application of a bank holding company to engage in permissible activities such as data processing, even though those activities have nothing to do with the granting of credit in the bank's community. Such requirements will add significant costs to most bank expansions and transactions.

We are very concerned that this expanded CRA process will come at the expense of safety and soundness. The House bill calls for a massive reorganization of the bank regulatory agencies and the hiring of large numbers of new examiners to exclusively examine for consumer compliance regulations. The human resources of the agencies have already been strained by the increased numbers of failed and troubled banks. The agencies have not found it easy to recruit new examiners urgently needed for safety and soundness examinations. The House bill would add additional pressures that could affect the agencies' ability to protect safety and soundness. We are also concerned about potential conflicts that could arise when banks have separate examiners for consumer issues and safety and soundness.

As a former examiner, I believe it is essential that all bank examiners understand the commercial activities and operations of a bank. Without experience in conducting safety and soundness examinations, a compliance examiner could easily overlook a problem. Safety and soundness examinations provide excellent training to a "green examiner" who has no knowledge of what banking is all about. Unfortunately, consumer compliance examinations do not teach examiners what banking is about. This is essential to every examiner's training.

Title IV also comes uncomfortably close to establishing a credit allocation scheme, which is clearly contrary to Congressional intent in establishing CRA. When evaluating a bank's compliance with the new CRA, the bill specifically directs the agency to emphasize three types of credit: "housing credit needs of low- and moderate-income persons, small business credit needs and small farm credit needs." Legislation should not emphasize specific types of credit. A financial institution's responsibility is to meet its community credit needs which may or may not include those elaborated in this bill. There could be considerable pressure on a bank to structure its loan portfolio in a certain way to get a high CRA rating, safety and soundness considerations notwithstanding. We believe the focus of CRA should continue to be on meeting the credit needs of the individual community.

The bill also establishes an entirely new data collection process for financial institutions with more than $100 million in assets. Banks would be required to provide information on five specific areas of credit. This focus on specific types of credit could result in great pressure on banks to make those loans in order to achieve CRA compliance, possibly without due consideration to an applicant's creditworthiness. Furthermore, most banks are already required, under the Home Mortgage Disclosure Act (HMDA) to report by census tract the number and total dollar amount of home purchase and home improvement loans originated each year. A new reporting requirement is redundant to these efforts. My bank annually completes a HMDA report. We have not had a single consumer request for this report since I have been at the bank. I question whether a new report would be of any more use to the public or just take precious time away from doing the business of banking.

Finally, we are opposed to the public disclosure by the agencies of a bank's CRA rating and evaluation. Public disclosure of specific agency reviews and dislosure of CRA ratings would have little meaning for the general public. This information could be used negatively to impair the safety and soundness of the institution or to hold the institution hostage to unreasonable demands. Presently, CRA requires a notice to be posted in the bank's lobby informing the public of their right to inspect our CRA file. Again, not once during my time at the bank has a single request to see either our CRA statement or CRA file been received. Consumers are not taking advantage of existing information yet groups that say they represent consumers are demanding more. (attachment #3)

While we hope that any legislation passed this year will not include these onerous CRA changes, we strongly urge your consideration of higher exemption levels for small banks or agricultural banks. Also, we suggest that some type of annual inflation adjustment be built into any such provision.

In conclusion, Mr. Chairman, we have serious objections to the provisions of Title IV. As you know, the funds availability legislation just took effect last week and banks have over 650 pages of regulations to comply with. Title IV would add six new consumer protection laws and hundreds of pages of more regulations. Add to that the enhanced enforcement powers for regulators and a possible credit card disclosure bill and community banks will be swamped with new regulations.

By their very nature, community banks serve the deposit and credit needs of their communities. Their success is directly dependent on the health and well-being of their home towns. I urge you to keep in mind the unique role of community banks as you consider these issues.

ATTACHMENT #2

$2.00 Fee For Cashing Non-customer Check.

Effective 11/1/86

Note: that these are light cardboard signs posted at the teller station.

ATTACHMENT #3

KENT CARRUTHERS
PRESIDENT

The Citizens Bank of Clovis

COMMUNITY REINVESTMENT ACT NOTICE

NOTICE: The Federal Community Reinvestment Act (CRA) requires the Federal Deposit Insurance Corporation to evaluate our performance in helping to meet the credit needs of this community, and to take this evaluation into account when the Federal Deposit Insurance Corporation decides on certain applications submitted by us. Your involvement is encouraged.

YOU SHOULD KNOW THAT

You may obtain our current CRA Statement for this community in this office. (Current CRA Statements for other communities served by us are available at our head office, located at 5th and Pile Streets, Clovis, New Mexico).

You may send signed, written comments about our CRA Statement(s) or our performance in helping to meet community credit needs to the office of the President, The Citizens Bank of Clovis, P. O. Box 1629, Clovis, New Mexico 88102-1629 and to Community Reinvestment Officer of the Federal Deposit Insurance Corporation, 1910 Pacific Avenue, Suite 1900, Dallas, Texas 75201. Your letter together with any responses by us, may be made public.

You may look at a file of all signed, written comments received by us within the past two years, any responses we have made to the comments, and all CRA Statements in effect during the past two years at our office located at 5th and Pile Streets, Clovis, New Mexico. (You may also look at the file about this community at The Citizens Bank of Clovis, Main Office, 5th and Pile Streets, Clovis, New Mexico).

You may ask to look at any comments received by the Federal Deposit Insurance Corporation's regional office at 1910 Pacific Avenue, Suite 1900, Dallas, Texas 75201.

You may also request from the Federal Deposit Insurance Corporation, Bank Supervision Division, Office of Consumer and Compliance Programs, 550 17th Street N.W., Washington, D.C. 20429, an announcement of applications coveredby the CRA filed with the Federal Deposit Insurance Corporation.

BOX 1629 • CLOVIS NEW MEXICO 88101 • PHONE 505 769 1911

AtTAchment # 3

KENT CARRUTHERS
PRESIDENT

The Citizens Bank of Clovis

AVISO SOBRE LA LEY DE REINVERSION EN LA COMUNIDAD

La Ley Federal de la Reinversion de la Comunidad ("The Federal Community Reinvestment Act: (CRA) requiere que la Corporacion (FDIC)) evalue nuestras actuaciones encaminadas a ayudar a satisfacer las necesidades de credito de esta comunidad, y que considere esta evaluacion cuando el FDIC vaya a decidir sobre ciertas solicitudes nuestras. Su envolvimiento se favorece.

"Usted debe saber que:

-Usted puede obtener nuestra Declaracion de CRA para esta Comunidad en esta oficina. (Las Declaraciones actuales del CRA para otras comunidades que nosotros servimos estan disponibles en la oficina central, localizada en 5th and Pile Street, Clovis, New Mexico.)

-Usted puede enviarnos sus comentarios escritos firmados acerca de nuestras Declaraciones sobre el CRA, o sobre nuestras actuaciones para ayudar a satisfacer las necesidades de credito de la comunidad a (Presidente de el Banco de Citizens de Clovis, 5th and Pile Street, Clovis, New Mexico.) y a (ofical de La Reinversion De La Communidad, Corporacion Federal de Seguro De Deposito, 1910 Pacific Avenue, Suite 1900, Dallas, Texas 75201. Su carta, asi como cualquier respuesta nuestra podra hacerse publica.

-Usted puede indagar en un expediente sobre todos los comentarios firmados recibidos por nosotros durante los pasados dos anos, cualquier respuesta que hayamos hecho a los comentarios y todas las Declaraciones de CRA en efecto durante los ultimos dos anos en nuestra oficina principal localizada en (5th and Pile Street, Clovis, New Mexico). (Usted tambien puede ver el expediente sobre esta comunidad en (oficial De La Reinversion De La Comminidad, El Banco de Citizens de Clovis, 5th and Pile Street, Clovis, New Mexico).

-Usted tambien puede ver cualquier comentario recibido por la Oficina Regional de FDIC en la oficina de 1910 Pacific Avenue, Suite 1900, Dallas, Texas 75201.

-Usted tambien puede requerir de la Corporacion Federal De Seguro de Deposito (FDIC), 550 17th Street, N.W., Washington, D.C. 20429 caulquier anuncio de solicitud cubierto por el CRA, radicadas en el FDIC.

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The **Chairman**. Thank you very much, Mr. Carruthers.

Our next witness is Mr. Blair Culpepper, president and chief executive officer of the Pioneer Savings Bank in Clearwater, Fl, representing the U.S. League of Savings Institutions.

STATEMENT OF J. BLAIR CULPEPPER, PRESIDENT AND CEO, PIONEER SAVINGS BANK, CLEARWATER, FL

Mr. **Culpepper**. Thank you very much, Mr. Chairman, members of the committee. It's my pleasure to be here today representing the U.S. League.

Pioneer Savings Bank is a $2 billion institution. We're headquartered in Clearwater in the Tampa Bay area and we're fortunate to be represented on this panel in the U.S. Senate by our former Governor and outstanding Senator Bob Graham.

The **Chairman**. And brilliantly represented.

Mr. **Culpepper**. Brilliantly represented, absolutely. [Laughter.]

The League appreciates this opportunity to address the various consumer provisions of H.R. 5094, which have been outlined earlier. I think I'd like to begin by mentioning the basic financial services account authorized by the House bill, the lifeline banking proposals.

While the intent of the no frills "basic transaction services" portion is commendable, the language contains several problems for savings institutions.

The House committee contemplated a noninterest-bearing account. Now don't ask me why but, as you know, Federal savings institutions and most State-chartered thrifts are not permitted under existing law to offer ordinary noninterest bearing checking accounts to individuals. Instead, we offer interest paying NOW accounts.

And the special transaction account pattern in the House bill would call upon our members to provide NOW accounts with less than $1,000 balances, quote, "for which service charges do not exceed a minimal amount."

In practice, given our lack of full demand account authority, it appears that we're being asked to provide a subsidized service, and it would be mandatory.

A special account at this time would only add to the considerable operating burdens, including the special deposit insurance assessment which we currently have, which apply to all of our institutions.

I would also observe that some savings institutions, big and small, do not choose to offer transaction checking accounts. They would be forced to do so under the House bill and, therefore, would have operational costs and Federal Reserve requirements.

Generally, we would suggest an exemption for Federal and State-chartered thrifts from the mandatory obligation to offer the basic transaction services account until full, noninterest bearing demand accounts are available to our institutions.

We would also suggest a family income or means test rather than the deposit account amount test in determining eligibility for these no frills, 10 withdrawal accounts. We must apply these to low-income individuals.

PROBLEMS WITH THE CHECK CASHING PROVISIONS

We also have practical problems with the Government check cashing portion of the basic services bill.

The provision requires that depositories cash checks up to $1,500 for registered special account holders. Apparently, any customer could demand currency and coin on presentation of a government benefit check.

Yet, many savings institutions are simply not equipped to handle such transactions. Institutions with locations near welfare or similar offices where benefit checks are distributed might find themselves inundated with check cashing requests on certain distribution days.

Timely service to regular customers would be disrupted. The permitted $2 charge may not be sufficient to meet added operational costs and expenses.

We have a very similar account at Pioneer. We charge $3, which does cover our cost.

We would suggest that only those institutions which routinely cash Government checks for regular customers should be required to offer the service for these registered special account holders.

Also, consideration should be given to requiring cash and coin distribution on Government check presentment only to the extent determined by management.

One portion of H.R. 5094 which has our unqualified support is the provision directing the Federal Reserve to study the feasibility and desirability of requiring direct deposit of U.S. Government benefit checks for entitlement programs. We really agree with this very strongly, Mr. Chairman.

We cannot support proposals which interfere with the fundamental managerial decisions at our institutions. Thus, we oppose the 90-day advance notice of branch closings required in the House bill.

Certainly, in this period of economic stress, management ought to be encouraged to trim excess operational costs whenever possible. And the language of title IV retards that process.

Other witnesses today will review adequately, I think, the unnecessary and expensive agency reforms, the establishment of the consumer divisions, creation of community review boards with broad, vague powers to second-guess supervision and examination, as well as the CRA changes.

I conclude by observing that with the recent implementation of expedited funds availability legislation, regulation CC, and the truth-in-savings and home equity disclosure provisions cleared by both House and Senate, depository institutions and their regulators have more than enough to digest and execute.

We think it best to defer the remaining provisions in title IV of the House committee's bill so the practical problems may be addressed, and these provisions refined in the next Congress.

Thank you very much, Mr. Chairman.

[The complete prepared statement of Blair Culpepper follows:]

Statement of J. Blair Culpepper
On behalf of the U.S.League of Savings Institutions
To the Senate Committee on Banking, Housing & Urban Affairs
September 8, 1988

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Blair Culpepper of Clearwater, Florida. I am President and Chief Executive Officer of Pioneer Savings Bank and appear today on behalf the U.S. League of Savings Institutions.

The League and its 3,100 member savings institutions appreciate this opportunity to address several matters appearing in Title IV of H.R. 5094, the Depository Institutions Act, reported by the House Banking Committee. These areas were not similarly addressed in S.1886, the Proxmire Financial Modernization Act, developed by your distinguished Committee and passed by the Senate on March 31 -- but may be the subject of your scrutiny if and when a common legislative product is developed, through a conference or otherwise, prior to the conclusion of this 100th Congress. Since the add-on provisions of Title IV of the House Committee's bill are several and distinct, I will discuss them separately.

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[*] The U.S. League of Savings Institutions serves the more than 3,000 member-institutions which make up the $1.4 trillion savings association and savings bank businesses. League membership includes all types of institutions -- Federal and State-chartered, stock and mutual. The principal officers include: Theo H. Pitt, Jr., Chairman, Rocky Mount, North Carolina; B. R. (Barney) Beeksma, Vice Chairman, Oak Harbor, Washington; William B. O'Connell, President, Chicago, Illinois; Philip Gasteyer, Executive Vice President and Director of Washington Operations; and Brian Smith, Senior Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue NW., Washington, D.C. 20006. Telephone: (202) 637-8900.

Access to Financial Services

H.R.5094 presents two proposals in what is frequently termed "lifeline banking" -- a basic transaction account and a cashing privilege for government benefit checks. The U.S. League shares the desire of the authors of these provisions to encourage all Americans to utilize the federally-insured depository system for meeting their basic bill-paying needs. In terms of safe-keeping and personal financial practices, our depository system is unsurpassed in fulfilling family financial services. The federal government's insurance-of-accounts programs, combined with the wide variety of choices at our nation's roughly 30,000 private-sector depositories, assures a convenient and safe place to keep household funds. Yet, we recognize that there remains a substrata of society which is, for whatever reason, intimidated by banking and thrift procedures and does not avail themselves of these opportunities.

While the intent of the "basic transaction service" of the House bill is laudable, the language as drafted contains several problems for the savings institutions represented by our organization. The House Committee report contemplates non-interest bearing demand deposits with balances of $1,000 or less, fewer than 10 transactions a month (including those at automated teller machines), and an opening or minimum balance of no more than $25, in its design of this mandatory, no-frills account.

As your distinguished Committee is well aware, under the Home Owners' Loan Act, federally chartered savings institutions may not offer non-interest-bearing checking accounts or demand deposits to individuals (or to businesses, for that matter, unless there is an established loan relationship). [During hearings in April before your panel on S.2073, Mr. Theo Pitt testified regarding this anachronism in the statutes under your jurisdiction -- an incredible situation eight years after so-called "deposit deregulation."] A comparable lack of authority to offer non-interest-bearing demand accounts exists in most States for state-chartered thrifts. Instead, we offer our customers interest-paying NOW (negotiable order of withdrawal) accounts to meet their transactions needs.

Thus, under the "basic transaction services" pattern set forth in H.R.5094, the vast majority of our member institutions would be called upon to provide NOW accounts of less than $1,000 balances "for which service charges ... do not exceed a minimal amount" (as determined by the Federal Reserve).

While we acknowledge our service responsibilities to our communities, and indeed in some circumstances may welcome the opportunity to cross-sell loan and other products to new customers attracted by the "basic transaction service" accounts, it seems unlikely that the pattern adopted by the House bill will work well in practice at our institutions on other than a subsidized basis, given our lack of full demand account authority. Your Committee has recently examined in considerable detail the operating difficulties currently confronting FSLIC-insured institutions nationwide. With the special 1/8 of 1% FSLIC assessment, most of our members already pay two-and-a-half times the deposit insurance premiums of comparably sized competitors. To add a subsidized, but mandatory, "basic transaction service" as set forth in H.R.5094 would compound these operational burdens.

We are also concerned that the formula for providing lifeline banking accounts in the House bill contains a deposit-size limitation, but no reference to income of the depositor. This raises the possibility that members of the general public of substantial means and with account relationships at other financial institutions might deliberately open "basic transaction service" accounts to avail themselves of below-cost services required at ours and other depositories. Note that because of the $1,000-or-less-on-deposit criteria of the House bill's "basic" account pattern, no opportunity to cross-sell other deposit products would exist for these customers.

We would also observe that there are still some institutions within our membership that do not offer NOW accounts or other transaction accounts at all in their normal course of business -- sticking to passbook and certificate of deposit services. (This is true not only for some small, neighborhood institutions, but for some larger institutions which have found by cost-benefit analysis that transaction accounts, with attendant Federal Reserve balances, do not fit their business plans.)

From the language of Section 422 of the House bill it would appear that, nonetheless, these institutions not offering NOW or transaction accounts presently would have to provide an account permitting at least 10 withdrawals per month. However, under existing rules, accounts with more than six withdrawals a month are by definition "transaction accounts" -- covered by the universal reserves requirements of the Federal Reserve. Such institutions would be put in a position of restricting any withdrawals in excess of six to "in-person" withdrawals -- obviously not the intent of the House provision. Institutions which do not offer NOW or transaction accounts currently should be exempted from the scope of H.R.5094's "basic transaction service" requirements.

As a more general proposition, the problems set forth above could be addressed by language exempting federally chartered and other thrift institutions not permitted to offer non-interest-bearing demand deposits. Such exemption, of course, would disappear when the Congress has the opportunity to rectify the anachronism of federal law denying full demand deposit opportunities to our business. Furthermore, we would suggest that if the Congress proceeds with the "basic transaction service" requirement, it impose a means test on individuals seeking to avail themselves of such low-cost accounts.

Cashing of Government Checks

The second portion of H.R.5094's "lifeline banking" provisions mandates that depositories with basic financial service accounts cash federal, State, and local government checks presented by an identified accountholder in amounts of up to $1,500, for fees not to exceed $2 per check, at three or more locations. The Federal Reserve is directed to implement this requirement.

Again, we appreciate the public concerns about the difficulty in promptly receiving currency and coin for government benefit checks. The safety and convenience of beneficiaries of government payments, many of them infirm or elderly, is a significant national problem, particularly in lower-income communities. The public should be encouraged to use federally insured and supervised depositories for basic services rather than liquor stores or currency exchanges. Some institutions will welcome the opportunity to acquaint persons establishing a check-cashing account with other products and services.

However, we foresee some practical problems with the language as drafted. For example, many savings institutions do not customarily keep large quantities of currency and coin on hand -- in part because they do not service the transactions accounts (as noted above) of convenience stores, restaurants, and other business customers which might routinely deposit funds in that form. Currently, when a Social Security beneficiary presents a monthly check, many managers are accustomed to distributing perhaps $200 or $300 in cash and coin, with the balance deposited in a savings account. H.R.5094 seems to require that amounts up to $1,500 would have to be disbursed in currency and coin on check presentment.

The mandated cashing of government checks may also present problems for institutions with branch offices in close proximity to welfare or other agencies which periodically distribute such benefit checks. Timely service to other customers could be disrupted significantly and operating/administrative costs could well exceed the $2 fee specified in the legislative proposal. It would indeed be counterproductive if the cashing of government checks requirement resulted in fewer service locations of depositories, particularly in inner-cities.

The House bill authorizes the Federal Reserve to issue regulations prescribing the details involved with the opening and maintenance of the check cashing service for those registered for basic financial services accounts. It also permits the Fed to suspend cashing for classes of checks where depositories are experiencing unacceptable levels of check-related fraud and similar abuses. While we have a very high regard for the Federal Reserve's ability to handle regulatory assignments, we suspect that the regulatory follow-through on these legislative requirements will not be a simple task ... and could rival the complexity of the recently implemented Regulation CC, governing Expedited Funds Availability.

While we are generally skeptical about the workability of the mandatory cashing of Government checks requirements of the House bill, if the Congress wishes to legislate in this area we would recommend at least two refinements. First of all, in recognition of the significant differences found at savings deposit-oriented thrift institutions, we would suggest a provision similar to that already provided expressly for credit unions in H.R. 5094. That is, only those savings institutions which routinely cash checks for regular accountholders should be required to cash government checks for the authorized "basic financial services" accountholders -- and distribution of cash and coin limitations should apply equally to both categories, as determined by management. Secondly, serious consideration should be given to exempting from the government check-cashing obligation those service locations of all depositories with deposit bases of less than an amount to be prescribed by the Federal Home Loan Bank Board or other appropriate regulatory agencies.

Direct Deposit Study

In our view, the greatest service that can be rendered at the present time to recipients of government checks is to encourage their use of direct deposit programs. We were pleased to see the House Committee include a study of the feasibility and desirability of requiring direct deposit of U.S. Government checks for entitlement programs among the proposals of Title IV of H.R. 5094.

Notice of Branch Closures

Title IV of the House Committee's bill also requires advance notice of not more than 90, nor less than 180 days, of branch office closings of national banks and federally chartered thrift institutions. The notice would be supplied to regulatory officials and to the customers of the facility involved, both through lobby postings and in periodic statements of accounts. If non-frivolous objections are filed with the agency, detailed justifications and analyses would be required of the institution wishing to close the facility. After receipt of such information, the Bank Board (in the case of our member institutions) must determine whether the closing of the branch will significantly reduce depository services in the area served and, if so, must consult with "leaders" in the affected area to explore replacement facilities. According to the House Report on H.R. 5094, removal of automated teller machines may also be considered branch closings. An exception to the advance notice requirement is made for situations where the FHLBB is accomplishing a supervisory merger or placing a troubled institution in receivership.

As a general proposition we cannot endorse the notice of branch closings provisions of the House Committee's bill since it interferes with fundamental managerial decisions at our federally chartered institutions. Certainly in this period of economic stress for the thrift industry, management ought to be encouraged to trim excess operational costs whenever possible. This provision retards that process

In a letter to Rep. Chalmers Wylie, the FHLBB applauded the supervisory-case exception as necessary to accomplishment of its consolidation program for troubled thrifts in its "Southwest Plan." It noted, however, that "it is not necessarily broad enough to cover all transactions involving failing thrifts." The U.S. League would support an "expanded exemption" as sought by the agency, if the Congress chooses to adopt the H.R. 5094 provision.

Agency Reforms

H.R. 5094 directs each federal financial institutions regulatory agency to establish, by 1991, a separate "consumer division" to conduct compliance reviews of consumer protection and community reinvestment laws no less frequently than every two years at all federally insured depositories under their respective jurisdictions.

Your Committee should be apprised of significant progress undertaken by the Federal Home Loan Bank Board in this area. This Spring, the Bank Board recruited the Federal Reserve's expert to head a newly-created Compliance Programs Division responsible for examinations of consumer-related laws. By the end of the year, that division will be fully staffed. The division has already published a "Self-Assessment Guide" to assist our members in consumer law compliance. A special team of examiners skilled in the intricacies of these laws is being developed and training will be given at the District Bank level. Moreover, each of the twelve FHLBanks has had in place either an office of community investment or housing investment which has received additional funding to increase staff and compliance monitoring activities. All of this has been accomplished at the Bank Board's initiative, without additiona statutory direction or demonstration of any decline in compliance in the savings industry.

Similarly, we see no need for additional statutory direction to the FHLBB for the establishment of Community Review Boards, as called for in Section 412 of the legislation under consideration today. The detailed selection of participants and the duties outlined suggest considerable interference with ongoing supervisory, compliance and enforcement functions and responsibilities. It is not inconceivable that the diversion of agency resources and attention to the operation of such Community Review Boards could detract the foremost assignment of the professional supervisory and examination staff -- assuring the safety and soundness of insured institutions which merit the public's trust.

Community Benefits

The House bill would impose complex and significant modifications to the Community Reinvestment Act and depositor holding company laws, including an elaborate rating system, public notice of CRA examinations and disclosure of a portion of examination reports, and compliance obligations on holding companies including civil money penalties. The portion of ou membership primarily affected by the provisions are the 250 o so registered savings and loan holding companies. The specified ratings of H.R. 5094 would have to be met for approval of: applications by S&LHCs to acquire another FSLIC-insured institution or holding company; applications b one insured institution to acquire another -- thus creating a S&LHC; and applications of S&LHCs to engage in nonbanking services and activities permissible for bank holding firms.

While other witnesses will evaluate these major portions of Title IV in greater detail, we would like to make several observations:

#- If Congress considers existing CRA enforcement by the various banking agencies to be inadequate or lax, expanding the scope of that 1977 law is not necessarily the correct response.

#- To obtain routine approvals for holding company applications under H.R. 5094, the applicant must attain an "excellent" or "good" rating on a five-tier scale for fulfilling specified CRA credit needs (e.g., home loans, small business loans, farm loans) -- but there may be other factors, such as local economic conditions, also relevant to FSLIC evaluations of applications.

#- The designated rating system imposes a comparative, rather than an objective standard -- contrasting the applicant's performance with other depositories. Holding companies with institutions rated "average" can only get applications approved if they commit to efforts to achieve "good" or "excellent" within two years, with constant pressure to maintain CRA lending which surpasses that of the institution's peer group. This creates a "treadmill effect" which could distort investment and financial decisions leading to safety and soundness concerns for the institution's management and its regulators.

#- The elaborate CRA revisions are particularly awkward when applied to companies which seek to become S&LHCs through the acquisition of savings institutions. The need to attract fresh outside capital to our industry has been documented repeatedly in other hearings before this Committee. Applicants for newly created holding companies must commit to attain one of the top two CRA ratings within two years, and, if they fail to do so, they would be subject to a $1,000-per-day civil money penalty. Thus, under the comparative rating scheme of H.R.5094, they would always be required to a higher CRA standard of performance than most of their peers. This is not the time to discourage fresh capital for the thrift industry. If the extra burdens of these CRA provisions acts to discourage potential acquirers, it would be a most unfortunate result.

The CHAIRMAN. Thank you, Mr. Culpepper.

Our next witness is John M. Kolesar, president and CEO of AmeriTrust Development Bank, Cleveland, OH, representing the Consumer Bankers Association.

STATEMENT OF JOHN M. KOLESAR, PRESIDENT AND CEO, AMERITRUST DEVELOPMENT BANK, CLEVELAND, OH

Mr. KOLESAR. Mr. Chairman, Senator Graham, good morning. As the Senator has introduced, I am Jack Kolesar from AmeriTrust Development Bank, Cleveland, OH, speaking today on behalf of the Consumer Bankers Association.

Both CBA and I appreciate the opportunity to testify today at this crucial stage, we think, in a process aimed at modernizing American financial services laws.

You may recall, Mr. Chairman, that I had an opportunity to address this committee in March of this year in the context of your hearings on the Community Reinvestment Act. While the focus of those hearings provided me with the opportunity to detail the success that our Development Bank has had with the very proactive approach to community reinvestment, my comments today will be less supportive, due primarily to the confrontational provisions of H.R. 5094, particularly with regard to the Community Reinvestment Act.

Nonetheless, I promise, however, to resist the temptation to ask at the conclusion of my testimony whether you love me in September as you did in March. [Laughter.]

Before we get into the arcane details of our testimony though, let me make our fundamental position very clear.

It is of paramount importance that banking legislation similar to S. 1886 move toward enactment this year.

While we respect the effort that the House Banking Committee has made to accommodate various special interests, the provisions of title IV in the House bill would compel us to abandon the effort that you have led us thus far along toward, Mr. Chairman.

Throughout this 100th Congress, the Consumer Bankers Association has shared with this committee a commitment to a modernization of the Nation's banking laws while assuring that consumer safeguards are not abandoned in the process.

Truth-in-savings, home equity and credit card disclosures are but a few examples of CBA's willingness to collaborate with the committee in the public interest.

That agenda, however, is seriously jeopardized, we believe, by the House Banking Committee's passing of burdensome consumer provisions in title IV of their Depository Institutions Act of 1988.

CUSTOMERS WOULD BE THE LOSERS

Instead of complementing the Senate's procompetitive reforms, title IV promotes a scheme of punitive interference in our joint efforts to serve our customers and your constituents. Except for a small subset of the population, customers would be the losers, not the beneficiaries of title IV's formula for credit allocation and subsidized entitlements.

CBA finds title IV's CRA provisions in particular to be fatally flawed. Notwithstanding this view, we do suggest, as Senator Bond has requested, certain refinements to the existing Community Reinvestment Act and we will offer additional ideas that may merit the committee's consideration.

Coming as I do from a bank that has experienced the Community Reinvestment Act from opposite extremes, first as the subject of three very bitter and protracted protests and more recently as a national model for CRA involvement, I am convinced that the CRA provisions of H.R. 5094 are totally contrary to the original intention of the Community Reinvestment Act.

First and of greatest importance is the fact that the legislative history clearly states that CRA is not and should never be a thinly veiled scheme of credit allocation. Both the spirit and the language of the House bill would definitively reverse that policy by codifying the abusive practice of allocating specific dollar commitments to specific geographic areas.

Second, the House bill poses a genuine threat to safety and soundness by compelling regulatory agencies as we heard this morning to divert important resources away from their fundamental mandate in order to propagate the preoccupations of a handful of professional antagonists.

Third, the original act was intended to foster public/private partnerships in urban revitalization. This legislation following upon the recent erosion of Federal support for local initiatives dissolves that intended partnership and obligates the industry to do more with less.

And, finally, H.R. 5094 effectively repeals the original public policy to, quote, "encourage banks to help serve the credit needs of low and moderate income communities," unquote, by removing all positive incentives for banks to take a more proactive posture in substituting a series of punitive measures, which will ultimately guarantee that only the largest money center banks will be likely to expand across geographic and product lines.

RECOMMENDATIONS FOR IMPROVING CRA

Let me move, Mr. Chairman, to the specific recommendations that we might make for improvements in the existing Community Reinvestment Act.

First of all, we would support a mandatory interagency uniformity concerning the examination and rating procedures.

Second, we would support an analysis of community credit needs which could assist us, the banking industry, in identifying specific service opportunities.

Third, we would support maximum time limits on public involvement in the application process; a regulatory study of the impact on CRA lending of secondary market and private mortgage insurance underwriting practices, as well as of disinvestment by nonbank financial service providers.

We support public disclosure of the regulators' assessment of an institution CRA record consistent with the suggestion made by Governor Johnson this morning.

We would support public notification of branch closings and we would encourage a scheme of CRA credit, if you will, for voluntary basic banking and government check cashing services.

Let me conclude, Mr. Chairman, as the light has gone on, as I began.

We do not expect this committee to reject any legislation simply because the industry doesn't like it. We have more respect for your responsibilities than that.

What we do suggest, however, is that the consumer provisions of H.R. 5094 serve no one's best interests, least of all the public interest.

It's not in the industry's interest to assume further regulatory expense. It's not in the Government's interest to direct resources away from fundamental attention to safety and soundness. And it's not in the public's interest to concede ever greater advantages to our foreign competitors.

Thank you.

[The complete prepared statement of John M. Kolesar follows:]

#- The FSLIC and other regulatory agencies must disapprove the applications mentioned above where the applicant or its insured institution subsidiary has a pattern of opening or closing facilities "in a manner that tends to exclude" low- and moderate-income neighborhoods. This language is unduly vague and does not appear to contemplate other factors which might lead management to make a business decision to discontinue service locations. It would be counterproductive if institutions preserved uneconomic locations because of this provision or new entrants into the depository business abandoned plans to locate in low- and moderate-income neighborhoods for fear of limiting future flexibility in expansion.

#- The bill appropriately exempts FSLIC supervisory acquisition transactions under Section 408(m) of the National Housing Act; however, as pointed out in an FHLBB letter to Rep. Wylie, a broader exemption covering transactions involving failing or failed institutions, including those under Section 406, would be desirable.

#- Though, as noted above, the FHLBB has made great strides in upgrading its examinations capabilities for CRA and other consumer protection laws, the procedures contained in Sections 404 and 405 of H.R. 5094 will place a tremendous administrative burden on its resources. The preliminary approval, final order, and two-year review time periods for applications rated "average" are at some variance with the speed-up in applications mandated as part of the Competitive Equality Banking Act last year.

Truth-in-Savings and Home Equity Loan Disclosures

This Committee and the Senate have previously processed portions of H.R.5094 concerning advertising of savings products ("Truth in Savings") and amendments to the "Truth-in-Lending" law to provide disclosures of home equity loans.

When the U.S. League testified last year before your panel on "Truth-in-Savings" legislation, our major concern was comparable treatment for deposit-like products offered the investing public from money market funds and similar instruments. That has been addressed in your language in S.1886 and by rule-making of the Securities and Exchange Commission governing the disclosure of past performance and yields. However, we would note that the SEC's task is not yet completed and a proposal is still pending governing the disclosure of advertising and distribution expenses of mutual funds under rule 12b-1.

Also, since the Senate passed S.1886, the House Banking Committee and the full House of Representatives have separately approved a home equity disclosure bill, H.R.3011, which is preferable, in our view, in several technical details to the earlier version approved by your panel.

Frankly, it will take considerable time and effort for the regulatory agencies and our nation's depository institutions to digest and implement the Truth in Savings and Home Equity Loan statutory provisions, coming, as they do on top of the Expedited Funds Availability start-up. With that in mind, it might be best to defer the remaining topics in Title IV of H.R. 5094 until the next Congress, so that they might be refined and improved for the mutual benefit of depository institutions, the agencies, and consumers of financial services.

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This completes the testimony of the U.S. League. I have appreciated this opportunity to present the League's views on Title IV of the Depository Institutions Act reported last month by the House Banking, Finance and Urban Affairs Committee.

TESTIMONY OF
THE CONSUMER BANKERS ASSOCIATION
BEFORE THE COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
CONCERNING THE CONSUMER PROVISIONS OF
H.R. 5094
DEPOSITORY INSTITUTIONS ACT OF 1988

Introduction

The Consumer Bankers Association ("CBA")[1] appreciates the efforts of the U.S. Senate this session, which has brought this country to the brink of a significant modernization of our banking laws. The Proxmire Financial Modernization Act of 1988, S. 1886, passed by the Senate in March, represents a critical consensus that the competitiveness of our financial services industry and the general consumer welfare will be increased by breaking down the barriers that prevent banks and thrifts from competing to serve all the financial needs (save insurance) of their customers, in the securities as well as the traditional banking areas. Moreover, while more competitive financial services environment will stimulate better services and lower prices for consumers, this also could be a banner year for consumer protection legislation, with the new expedited funds availability law in effect this month and the pending provisions in S. 1886 governing home equity loan and truth in savings disclosures.

The consensus represented by S. 1886 is being threatened, however, by a highly controversial, ill-advised, and insupportable set of so-called "consumer" measures contained in the Depository Institutions Act of 1988, H.R. 5094, currently under consideration in the House. That bill, and in particular, subtitles A through D of Title IV, have turned Congress' goal on its head. Instead, H.R. 5094, by radically expanding the Community Reinvestment Act of 1977, 12 U.S.C. sections 2901-05 ("CRA") into a menu of specific entitlements, would promulgate a whole new level of bureaucracy, red-tape and interference in the efficient operation of the market for financial services. Except for a small sub-set of special interests, consumers would be the losers, not the beneficiaries of the proposals.

For these and other reasons detailed later in this testimony, the CBA respectfully submits that the community reinvestment provisions in Title IV are fatally flawed. This is not to say that modest CRA refinements cannot be effected should Congress deem it appropriate after due deliberation. In fact, the CBA will offer certain suggestions along these lines. What is critical at the moment, however, is for all parties to have a clear understanding as to what we have learned after eleven years of CRA experience and what unfortunate road the CRA proposals in H.R. 5094 may lead the economy down.

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[1] The Consumer Bankers Association was founded in 1919 to provide a progressive voice for the retail banking industry. CBA represents approximately 700 federally insured banks, savings and loans and credit unions that hold more than 80 percent of all consumer deposits, and more than 70 percent of all consumer credit held by federally insured depository institutions.

First and most importantly, it is critical to recall that, despite the proposals of some special interest groups, the CRA never was intended to create a system of forced credit allocation to low- and moderate-income neighborhoods or mandate subsidized benefits from the private sector. The CRA was not envisioned as a substitute for government funded programs for the poor. Instead, through the CRA, Congress instructed bank regulators to encourage financial institutions to make good faith efforts to help meet community credit needs, but expressly rejected forced credit allocation as a highly suspect interference in the operation of this nation's credit markets. To the extent the CRA has resulted in credit allocation, it is only because of abuse of the act by those who have used their leverage under the act to extort money from banks who cannot afford delays in their regulatory approval processes. H.R. 5094, by contrast, would institutionalize a scheme of credit allocation.

Second, because H.R. 5094 mandates bank subsidization of low-income lending and because it imposes a set of regulatory burdens that the Federal Reserve Board ("FRB") has termed "unusually complex and unnecessarily lengthy and costly,"[2] the bill completely undercuts the purpose of the Glass-Steagall reforms. Instead of placing banks on an equal footing with securities firms, H.R. 5094 heaps additional burdens on banks that desire to enter the securities field, while their securities competitors continue to operate unaffected, or only minimally affected, by such burdens. By contrast, those same securities firms, along with many other non-bank competitors, such as offerors of money market accounts and nonbank banks, aggressively compete with banks for "deposit" accounts unhampered by the CRA and related amendments.

Third, many of the new burdens created by H.R. 5094 apply to bank holding companies, not banks themselves. These burdens are incurred not only when bank holding companies attempt to enter new areas such as the securities field, but apply to virtually any activity in which a bank holding company seeks to engage. Proponents of these provisions justify this action on the basis of the "obligation" of "banks" to reinvest in the community from which their deposits are drawn without considering that (1) the "deposit-taking" activities of banks no longer constitute a service unique from the "deposit-taking" activities of many other entities, such as mutual funds or money market accounts and (2) the entry of holding companies into securities or other nonbanking activities has little to do with the bank's deposit-taking "franchise." Non-bank subsidiaries and affiliates do not collect deposits, are not protected by federal deposit insurance, do not have the privilege of borrowing at the discount window, are primarily institutional service providers which seldom deal directly with the consuming public, and often are not situated in the affiliate bank's community. We would also note that the Proxmire Financial Modernization Act of 1988 makes a similar mis-step in this direction at section 914 of Title IX.

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[2] Staff Comments on Subpart A of Title IV, Community Benefits, at 4 (Enclosure to Letter of Alan Greenspan to the Honorable Fernand J. St Germain, July 21, 1988)

Fourth, the burdens of H.R. 5094 will not be borne by banks and their customers alone. H.R. 5094 creates a costly regulatory morass for the regulatory agencies which will interfere with their ability to pursue many of their other policy goals in maintaining the safety and soundness of the nation's banking system and the economy.

Fifth, by expanding the powers of community organizations in CRA proceedings, H.R. 5094 will subject even banks with exemplary CRA records to the possibility of constant challenges. And sixth, H.R. 5094 requires banks to provide "basic banking" accounts and government check cashing at minimal prices, two costly entitlements the need for which has yet to be established as a matter of record.

Despite the obviously critical relationship of these highly objectionable provisions to the viability of any banking bill, the only hearings in the House on these provisions were held in the Housing and Consumer Interests Subcommittee of the House Select Committee on Aging, an entity with no jurisdiction over H.R. 5094. This is quite unfortunate because the provisions present major policy issues, including the fundamental question whether the U.S. is moving in the direction of state central planning by requiring the private sector to provide subsidized services.

We appreciate this opportunity to set the record straight. This testimony begins by briefly setting forth the original purpose of the CRA. We then show that although the CRA has helped focus the attention of banks on the credit needs of their communities and has stimulated salutory relationships between banks and community groups regarding those needs, protest groups have used the CRA to their own ends to pervert that purpose by forcing credit allocation on banks wishing to expand. Next, we comment on the CRA provisions of H.R. 5094 itself, showing that they contemplate a burdensome system for credit allocation completely antithetical to the original purposes of the CRA, sound policy, and the current purposes of Glass-Steagall reform. We then offer some possible refinements to existing law and pose several additional ideas. We also address our objections to the basic banking, check cashing and branch closing provisions of Title IV, as well as our concerns with respect to the funds availability, disclosure and credit discrimination provisions in the House bill.

I. The Limited Purpose of the Community Reinvestment Act

The CRA had its genesis in the concern in the mid-1970s over (a) arbitrary discrimination in the granting of credit ("redlining"), (b) the taking of deposits in low- and moderate-income areas and lending those funds elsewhere ("credit exportation") and (c) the general process of urban decay, which was perceived as both a cause and effect of the credit flight from poorer neighborhoods. Although Congress concluded that the complex social problem of disinvestment in the inner cities could not be blamed on any particular group, Congress believed that financial institutions had the capacity and responsibility to assist in a broad-based social program aimed at revitalization of the cities. This position was predicated on several presumptions, including:

> [I]nvestment by financial institutions in their communities need not involve risks greater than those normally taken by prudent lenders, and often involves less risk because of the lender's firsthand knowledge of his community.
> [A] public charter conveys numerous economic benefits and in return it is legitimate for public policy and regulatory practice to require some public purpose, without the need for costly subsidies, or mandatory quotas, or a bureaucratic credit allocation scheme.[3]

Chief among the banks' "economic benefits" which were thought to justify the formulation of an obligation to "reinvest" funds in the local communities was the pre-deregulation uniqueness of the banks' deposit-taking franchise. It was argued that, unlike other institutions, banks possessed a deposit-taking power that enabled them to collect funds from the general public with little competition and at an artificially low, regulated cost. Therefore, some took the position that banks could be obligated to return some of those funds through lending in the local community. Indeed, some proponents of CRA demanded credit allocation and other subsidies to low-income neighborhoods based on the asserted competitive benefits to banks from the deposit-taking franchise. As discussed below, however, the value of that franchise has decreased with the decline of its uniqueness since 1977.

Although concerned with the discriminatory allocation of credit based on unwarranted presumptions about the creditworthiness of particular areas and groups of people or based on the unintended consequences of the application of certain credit qualification criteria, Congress remained wary of the proposed governmental credit allocation scheme. Some of the concerns regarding credit allocation that led Congress to remove proposed credit allocation measures from the CRA were summarized in the testimony of Robert Bloom, the acting Comptroller of the Currency:

> Our present system of credit allocation is based in large measure upon vigorous competition among numerous financial intermediaries. For the most part, it works well. However, the bill's narrow focus upon retail markets may encourage regulatory agencies to ignore one of the most

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[3] Community credit needs: Hearings on S. 406 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 95th Cong., 1st Sess. 9 (1977) ("Hearings on S. 406") (opening remarks of Senator Proxmire).

> important roles of the nation's commercial banking system, i.e., to serve as a major supplier of short- and intermediate-term credit to business and industry. Thus, the bill, while well-intentioned, could conceivably force short-term regulatory actions which could have impact upon employment, municipal services, and innumerable other economic interests essential to the nation's well-being and, indeed, to the welfare of the very retail customers which the bill is designed to benefit. We have serious reservations as to whether any regulatory agency could have the wisdom necessary to administer such a system to the maximum benefit of competing economic interests. Such a governmentally encouraged departure from the established mechanisms of our complex credit economy should be approached with extreme caution.[4]

As Senator Proxmire stated when the bill was debated, "this was not a credit allocation plan and I certainly don't see it that way. Whatever we can do to prevent it from being a credit allocation bill I want to do."[5]

Instead, the CRA instructed the federal regulators to "encourage" financial institutions to "help" meet the credit needs of the communities in which they are chartered in a manner consistent with safe and sound banking practices. As one commentator aptly described this scheme, "The [CRA] resolved the dispute over principles and required good-faith efforts to improve lending practices. In an age in which government regulation commonly took the form of detailed requirements, quotas, and timetables, C.R.A. followed a very different model. It established a direction and goal, and then allowed private industry latitude and discretion in choosing methods to attain the goal."[6] Thus, rather than demand that the industry subsidize lending in or allocate credit to low- and moderate-income neighborhoods, Congress created a mechanism to ensure that such areas would not be overlooked. As even the House Report on H.R. 5094 recognizes, "the legislative premises underlying the Community Reinvestment Act of 1977" were "(1) institutions should be given flexibility in deciding how to marshall their resources to serve local community credit needs; (2) regulatory judgment is the key in CRA implementation; and (3) *CRA should not be used to impose any credit allocation scheme on banking institutions.*"[7]

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[4] *Hearings on S. 406*, at 13. *See generally* Brandel and Lange, A Compliance Guide for the Community Reinvestment Act 17-21 (Consumer Bankers Assoc. 1978). Convinced that the allocation of credit to its most productive uses was best achieved through the free market, Congress therefore emphatically rejected the concept of a government-mandated credit allocation scheme when it passed the CRA, voting down proposals that would have required banks to make certain commitments to lend in their "primary service areas."

[5] *Hearings on S. 406*, at 156. *See also id.* at 2, 9 (further comments of Senator Proxmire); Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 813 (1981)(FRB staff study emphasizing that "the Board has noted repeatedly that it does not believe the CRA was intended to require lending institutions to allocate credit").

In addition, the legislative history of the CRA makes clear that the CRA was intended not to increase compliance costs of financial institutions or the regulatory burden on federal agencies. Concerns that the CRA would proliferate the red-tape in an already heavily regulated industry were often the subject of comment in the Senate hearings on the bill. The legislative record is replete with assurances by the CRA's proponents that no new reporting requirements would be imposed on financial institutions under the CRA:

> The question whether the bill will increase the regulatory burden on financial institutions was thoroughly considered by the Committee. . . . As originally introduced, S. 406 [CRA] would have required the filing of certain additional material. . . . [A]fter a full discussion, [the Committee] concluded that these additional reporting burdens would not be necessary or appropriate to the enforcement of this Title.[8]

Likewise, it was understood that the CRA would not provide new authority to regulators or inject a new element into the deposit facility application process. Senator Proxmire made clear when introducing the bill that the CRA would not "provide any new authority to the bank regulatory agencies":

> The bill would not inject any significantly new element into the deposit facility application approval process already in place. Instead, it merely amplifies the 'community need' criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes 'community need,' to make clear that it includes credit needs.[9]

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[6] Art, *Social Responsibility in Bank Credit Decisions: The Community Reinvestment Act One Decade Later*, 18 Pac. L.J. 1071, 1073 (1987).

[7] H.R. Rep. No. 822, 100th Cong., 2d Sess 127 (1988) (emphasis added).

[8] S. Rep. No. 175, 95th Cong., 1st Sess. 34 (1977).

[9] *Hearings on S. 406*, at 10. Similarly, the Congressional Budget Office reported that since the additional regulatory burden posed by the CRA would be incidental to the regulator's current burdens, "no significant additional cost

II. Misuse of the CRA by Special Interest Groups

To a great extent, the CRA has been successful at achieving its goals. There is no doubt that banks and community groups have entered into productive dialogues across the country regarding the credit needs of local communities. Furthermore, many banks have instituted programs that attempt to reach out to those segments of the community that have been isolated from the mainstream. For example, some banks have created an entirely new subsidiary for the express purpose of developing lending in low- and moderate-income areas.[10] One such institution, Ameritrust Development Bank, has lent millions of dollars on the basis of its own market evaluations, not because it was forced to do so through a central planning mechanism. Many other banks (including such diverse organizations as Commerce Bankshares, Ohio Citizens Trust, Michigan National Corporation, Ameritrust Corporation, First National Boston Corporation and many others) have instituted programs to increase the advertising of their credit services in low-income areas, to intensify the training of their personnel in consumer compliance matters, and to interact regularly with representatives of their communities in order to increase awareness of community needs. Indeed, these factors have been central to the regulatory approval process under the CRA[11], thereby engendering precisely the attention to community credit needs sought by the CRA.

Despite the success of this clear policy of the CRA to "encourage" lending in a financial institution's local community without mandating a geographic or product mix, the Act has fallen to abuse by special interest groups who see the CRA as a tool for imposing social policies that Congress had rejected. Indeed, CRA protestors have stated openly, "'There's been tremendous cutbacks in federal housing money. We have to look elsewhere for financing.'"[12] "Elsewhere" has turned out to be banks whose legitimate and pressing applications for new offices, branches, mergers and acquisitions have been threatened with costly delays by CRA protestors.

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will be incurred." *Compilation of the Housing and Community Development Act of 1977, Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 95th Cong., 1st Sess. 346 (1977).

[10] *Community Reinvestment Act; Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs*, 100th Cong., 2d Sess. 172-83 (1988) ("*CRA Hearings*").

[11] *see* Canner, *Progress Report*, *supra*, at 815

[12] Ansberry, *Banks with Interstate Ambitions are Challenged by Law Requiring Commitment to Local Lending*, Wall St. J., June 26, 1986, at 64, cols. 5-6 (quoting Michael Shea of ACORN, a group which has been involved in CRA protests throughout the country). *See also* *The 'Blackmail' Making Banks Better Neighbors*, Business Week, August 15, 1988, at 101.

Unwittingly, the CRA had provided these groups the capacity to delay consideration of bank applications for charters, deposit insurance, branches or other deposit facilities, office relocations, mergers or acquisitions, and, as a direct consequence, provided to those groups the ability to demand payment from banks as a prerequisite to removing the delay. Such delays are very expensive and disruptive to banks, their employees, creditors and shareholders, and the public they serve. Delays can even mean the failure of a transaction, particularly in the current interstate environment of mergers and acquisitions among financial institutions.

Therefore, rather than rely on a good CRA record and obtain a regulatory approval only after months of delay, banks frequently are forced to concede to demands to provide low cost loans and a variety of subsidized programs, even outright cash grants, in what many view as a "payoff" to enable the banks merely to proceed with their legitimate operations.[13]

The strategy of the CRA protestors is quite simple; when a bank files an application to engage in one of the above activities, the groups file or threaten[14] to file a protest based on an alleged deficiency in the bank's history of meeting the credit needs of its community. Regardless of whether the challenge is meritorious or not, delay, often substantial delay, is inevitable because notification periods and more rigorous regulatory review are triggered.[15] For example, although the FRB eventually approved Hibernia Corporation's merger with Southwest Bancshares over the objection of various groups, the protestors were able to delay a decision on Hibernia's application for eight months because Hibernia did not cave in to their demands.[16] Indeed, protested applications within the Federal Reserve System typically are delayed for 6 months or more (sometimes for over a year), instead of the average of 40 days or less typically needed for approval of an application.[17] As a summary of all CRA protests lodged in the Federal Reserve System through September 1, 1981 reveals, out of 19 protested applications, 11 were delayed for over 6 months, 7 of which were delayed from 8 to 14 months.[18]

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[13] *See, e.g.*, Mannion & Faber, *Hibernia Sets Example in Community Reinvestment Act Protest*, American Banker, September 5, 1986, at 4. *See also* *Avoiding CRA Pain is No Simple Thing*, ABA Banking Journal 6 (December 1987)(characterizing as "extortion" the threat of delay to extract concessions from banks).

[14] *See* Ansberry, *supra*, at 64, col. 3 (mere threat of CRA protest is enough to force banks to bargaining table); Mannion & Faber, (description of Chase Manhattan Bank's negotiations with community groups to prevent the filing of a CRA protest)

[15] *See* Art, *supra*, at 1101 n.127.

[16] Mannion & Faber, *supra*.

[17] *See* Art, *supra*, at 1101 n. 127; Staff Comments, *supra*, at 15.

[18] *See* Canner, *Progress Report*, supra, at 819-23.

The importance of this ability to delay should not be underestimated. Banks, and our society, incur heavy costs during these protest periods, including the regulatory costs of responding to the protests, the carrying costs of holding up an investment and the potential loss of business opportunities.19 Particularly with respect to the increasingly active mergers and acquisitions area, delays can be devastating, decreasing the likelihood that the transaction will be consummated and sharply affecting the morale of employees, customers, and creditors alike. For example, the devastating effect on Irving Bank employees of the ongoing Bank of New York-Irving Bank Corp. negotiations can be seen in actual letters to the FRB from employees who fear for their jobs.20

Consequently, the CRA has proved an irresistible temptation for special interest groups who can "impose expensive delays on applicants in order to extricate agreements" that subsidize their efforts to affect social policies that are inconsistent with the policies of those elected to set those policies, in this case, the Congress of the United States.21 This has been particularly true in recent years as the financial institutions of the U.S. have begun reorganizing into more efficient units through bank mergers and acquisitions, which have presented new opportunities for protest groups to use their leverage in particularly sensitive situations. As Governor Martha Seger of the FRB noted in her testimony before the Senate earlier this year, the FRB alone has seen a ten-fold increase in the number of formal CRA protests filed between 1984 and 1987.22

As noted at the outset of this testimony, community groups have been open in their use of the CRA to force banks to economically underwrite a wide variety of programs. Their primary goal has been credit allocation, despite the explicit rejection of that concept in the CRA. "Groups often demand commitments from lending institutions to provide real estate loans in a particular neighborhood in a prescribed amount or to accept a prescribed percentage of deposits drawn from that neighborhood."23 For example, when a coalition of community groups protested United Virginia Bank's acquisition of National Savings and Trust, they were able to force United Virginia to commit to make $10 million in loans to low-income neighborhoods. As an attorney for the coalition admitted, "it was only when the bank had an appeal pending (for the acquisition) that we had real leverage."24 Similarly, a

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[19] *See, e.g.*, Art, *supra*, at 1102 ("The delay in processing may cause arrangements for the planned acquisition of real estate to lapse, planned construction to be disrupted, or competition from other institutions to arise.").

[20] *See* Rehm, *Banking Industry is Absent from Appeals to Fed*, American Banker, February, 26, 1988, at 16.

[21] *See* G. Canner, The Community Reinvestment Act and Credit Allocation 5, 5 n.22 (Bd. Govs. Fed. Res. Sys. Staff Study 117, 1982)("Canner, Credit Allocation").

[22] CRA Hearings at 209.

[23] Art, *supra*, at 1099.

[24] Ansberry, *supra*, at 64, col. 2.

representative of ACORN, one of the most active organizations in CRA protests across the country, told reporters, "'When you're talking a billion-dollar merger, every day of delay costs lots of money. It's cheaper to negotiate than to fight.'"[25]

United Virginia Bank's experience is typical. Generally, CRA protests threaten unacceptable delays, regardless of the banks' good faith efforts to meet the credit needs of their local communities, thereby forcing the banks to accept various credit allocation packages proposed by the protestors. Other banks have been forced to make even greater commitments. For example, in one of the most egregious instances of attempted credit allocation to date, Great Western Savings and Loan Association was requested to extend $1.25 billion in residential loans in minority and low-income areas over a four-year period and to purchase an additional $100 million of loans from minority-operated savings and loans as a condition to a merger.[26] It should be no wonder that the merger subsequently was cancelled under these burdensome provisions.[27]

Similarly, when First National Bank of Chicago attempted to acquire American National Bank of Chicago in 1984, an activist group threatened to protest unless the bank committed to make $500 million in loans to poor neighborhoods. After a few weeks of negotiations, that figure was whittled down to $120 million in loans to low-income groups, plus a variety of other concessions, in exchange for the groups' promise not to protest the bank's application.[28] Other representative commitments extracted from banks across the country include: Midlantic Banks, Inc. acquisition of Continental Bankcorp. Inc. -- $85 million in low income neighborhood reinvestment package; California First acquisition of Union Bank -- $84 million in housing-related and small business loans over two years in minority and low-income communities; Fidelity Bank N.A. acquisition of a smaller local bank -- $60 million of targeted lending; Fleet Financial Group acquisition of two banks -- $50 million commitment to lending for low- and moderate-income housing.[29]

Credit commitments have not been the only concessions extracted from banks who cannot afford the delays imposed by CRA protests. With their success at enforcing credit allocation to low-income areas, protest groups have begun demanding subsidization of other services as well, including outright cash grants in a number of instances. Typical demands have included below-market interest rates on home mortgages, free basic banking accounts, and free government check cashing. Indeed, the FRB staff's recent review of the entire basic banking issue noted:

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[25] Gourevitch, Demands for Local Credit Shape More Bank Mergers; Community Activists Flex Law to Win Loan Promises, American Banker, June 2, 1986, at 17.

[26] See G. Canner, Credit Allocation, supra, at 7.

[27] Id. at 7, n.38.

[28] Gourevitch, supra.

[29] See Ansberry, supra, at 66, col. 2; Pierce, Neighborhood Challenges to Big Bank Mergers, Nat'l. Journal, July 18, 1987, at 1862.

> Besides filing formal protests, an increasing number of community groups have been informally pressing their demands for basic services with banks that are considering applications. The result has been several agreements in which banks have committed to offer transaction accounts at reduced prices, to cash government checks for noncustomers, and to lower fees for cashing government checks.
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> In 16 out of 22 agreements recently reviewed by Federal Reserve staff, basic banking was a negotiated issue.30

Moreover, outright cash grants have become quite extensive. For instance, in 1987 First Chicago made more than $500,000 in grants for community activities, including a $30,000 grant to the National Training and Information Center, a major organizer of CRA protests!31 Similarly, in addition to a $50 million low-income loan package, Boatmen's National Bank of St. Louis committed to basic banking accounts, free government check cashing, and a *$100,000 outright grant to community organizations*, all in order to get a community group to call off its protest of the bank's merger with General Bancshares Corp.32 A similar commitment was made by Chase Manhattan Corporation when it acquired Continental Bank of Arizona, including low-cost checking, $2 million in home mortgage loans for low- and moderate-income housing, and a *$100,000 outright grant to Arizona nonprofit organizations*.33

Finally, protestors also have used the CRA to force banks to open new offices in neighborhoods that allegedly have become "underbanked."34 For example, a branch was opened in North Philadelphia when Equibank of Pittsburgh moved into Philadelphia.35

There can be no doubt that the CRA, an act intended to focus industry and regulatory attention on the credit needs of local communities, has been twisted virtually beyond recognition. Out of 92 protested applications considered by the FRB by September of 1987, 70 resulted in negotiated settlements or commitments by banks to meet various elements of the protestors' agendas.36 Moreover, for each

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30 Canner, *Basic Banking*, 78 Fed. Res. Bull. 255, 258 n.8 (1987).

31 Schmitt, *Public Service or Blackmail? Banks Pressed to Finance Local Projects*, Wall St. J., September 10, 1987.

32 Gourevitch, *supra*.

33 *See* Mannion & Faber, *supra*.

34 *See* *Basic Banking*, *supra*, at 258.

35 *See* Pierce, *supra*.

36 Newman, *Protests Haven't Stopped Bank Mergers; Reinvestment Act of 1977 Used Mainly to Influence Policies*, American Banker, at 10.

application that actually results in a formal protest, many more result in commitments by the banks to forestall a protest being filed. Almost all of these commitments involve some element of credit allocation or other subsidization of local protestor goals at the expense of the bank and its paying customers.

Thus, although the protest groups continue to complain that banks are not lending "enough" to low- and moderate-income groups, they are proud that an estimated $5.2 billion of loan commitments for low-income housing and other projects directly attributable to CRA actions.37 This tax on the banks of our country has had a predictable result; empirical research has shown that the CRA has caused banks to retreat from establishing facilities in low-income areas because of the added burden of operating there. One study of the issue states that although "low income was not a significant consideration [in the establishment of bank branches] before 1977 and the CRA," the enactment of the CRA "has retarded branching activity into CRA-defined low-income areas."38 The report concludes:

> The results indicate that, contrary to the intent of the CRA, to assure that deposits generated in low-income areas would be loaned there, the actual impact appears to be that less deposits are being generated in these areas by both commercial banks and savings and loan associations. For each 100,000 population, empirical results suggest approximately one less bank and one less savings and loan branch for CRA as opposed to non-CRA areas. The reduction in services provided to these areas appears to be directly related to the Community Reinvestment Act.39

Of course their reaction to this situation, embodied in H.R. 5094, is the reaction of all central planners -- further regulation to prevent banks from leaving low-income areas and to force them to open branches in those locations. Thus, H.R. 5094 makes a bank's "pattern" of acquiring, chartering, opening or closing deposit facilities or depository institutions in low- and moderate-income areas, the decisive factor. The existence of such a pattern requires rejection of any bank or bank holding company application by the FRB, no matter how favorable the overall application may be to the community. This type of central planning has been discredited as a method of addressing social issues. Obvious distortions that may result from H.R. 5094's attempt to allocate deposit facilities are the direction of bank resources away from nonbanking activities and an increase in the number of single branch institutions located solely in affluent areas. Many more distortions may

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[37] CRA Hearings, supra, at 149 (Testimony of Allen J. Fishbein, General Counsel, Center for Community Change).

[38] Booth & Smith, The Impact of the Community Reinvestment Act on Branching Activity of Financial Institutions, 15 Journal of Bank Research 123, 128 (1984).

[39] Id. Thus, by interfering with the free market allocation of credit, the protest groups have initiated a process that harms many of the very people the CRA was intended to benefit.

more distortions may follow as each new escalation of the interference with the efficient functioning of the free market system only increases the costs to society and, frequently, to those it is intended to help. Instead, the CRA should be given the effect that it originally was intended to have, allowing the banks to meet legitimate community credit needs through the operation of the marketplace.

We suggest that the more appropriate response to the history of abuse of the CRA would be for Congress to amend that law to limit the ability of protestors to use costly delays to extort money and credit from banks. For example, one approach would be to require an expedited hearing process for CRA complaints so that banks that wish to stand on their CRA records can do so without prohibitive cost. Otherwise, banks will continue to be subject to the increasingly excessive demands of protestors who even have gone so far as to demand that banks "reduce [their] profit margins to the point of loss. Frankly, we are declaring that a penalty must be assessed against banks [for alleged noncompliance with the CRA]."[40] Such attitudes and actions have nothing to do with the actual purposes of the CRA and bode ill for its future enforcement.

III. The Community Reinvestment Act and H.R. 5094: A Formula for Credit Allocation and Subsidized Entitlements

H.R. 5094, like S. 1886, started out as a step forward for the financial services industry by allowing commercial banks access to various investment banking activities. As the House Report on H.R. 5094 notes, the current "compartmentalization" of commercial and investment banking are "out of step with the financial service needs of consumers."[41] Similarly, the Senate Report on S. 1886 states unequivocally:

> The major purpose of S. 1886 is to strengthen competition within the financial services industry under a sound and consistent regulatory framework.
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> Allowing bank holding companies to establish securities affiliates under the proper safeguards will increase the level of competition within the investment banking industry. This enhanced level of competition will result in lower financing costs and greater access to capital by

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[40] Letter of Bob Lincoln, President of the Fresno Organizing Project, and Rosa Inuwa, Chairperson of the CRA Division Reinvestment Committee, to Joseph J. Pinola, Chairman of the Board and Chief Executive Officer of First Interstate Bancorp, August 21, 1987.

[41] H.R. Rep. No. 822, 100th Cong., 2d Sess. 102 (1988).

> business firms, consumers and State and local governments.42

While S. 1886 continues to reflect the goals of improving the price, quality and convenience of financial services for consumers through increased competition, however, H.R. 5094 has abandoned them in favor of a highly regulated and subsidized marketplace for financial services and government/interest group mandated allocation of credit. Indeed, the abuse of the CRA over the years pales by comparison to the potential affect on the banking industry of Title IV of H.R. 5094. The impact of Title IV's "Community Benefits" provisions on the overall banking bill is so extensive that H.R. 5094's chief effect will be heightened regulation and decreased efficiency for the banking industry and an increased cost and regulatory oversight burden for the federal regulators. Glass-Steagall reform will be left almost as a footnote to an overall pattern of regulatory overkill.

A. Federally Mandated Credit Allocation

First and most fundamentally, in spite of H.R. 5094's purported adherence to the principle that "CRA should not be used to impose any credit allocation scheme on banking institutions,"43 H.R. 5094 is an attempt to repudiate Congress' decision in 1977 not to impose a system of credit allocation on this nation's banks. As Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, wrote to Representative St Germain on July 21, 1988:

> [The purpose of the CRA] is to require depository institutions to make real and meaningful, good faith, efforts to assure that local communities are aware that the banks' credit facilities are available to serve those communities without discrimination, and for those institutions to seek to meet those needs consistent with their safe and sound operation.
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> There are others who earnestly, but I believe mistakenly, have the view that CRA in effect constitutes a directive, to regulators and to banks, that banks should make certain kinds of loans, to specific areas and, in some cases, on concessionary terms. My concern is that the community reinvestment provisions of Title IV go too far, perhaps unintentionally, in the direction of the latter interpretation by establishing elaborate new data collection, examination, application, comparative rating,

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[42] S. Rep. No. 305, 100th Cong., 2d Sess. 2-3 (1988).

[43] H.R. Rep. No. 822, at 127.

> and evaluation systems that have *the cumulative effect of requiring an above average amount of lending for specific purposes in order to obtain a CRA rating that will permit the bank to expand.*[44]

The central factor in H.R. 5094's creation of a de facto credit allocation scheme is its implementation of a new comparative rating system, combined with special consideration for certain types of lending. Under the new five point grading system, banks will be assigned grades from 1 through 5, with 1 representing "excellent" performance, 2 representing "good" performance, 3 representing "average" performance, 4 representing "limited effort," and 5 representing "poor or substantial noncompliance." Although the House Report insists that this system does not create a "'bell curve' that would automatically push a certain percentage of institutions into the bottom rungs,"[45] it is clear that for category 3 to be "average" in any literal sense of the term, large numbers of banks will in fact be given a grade of 3 and that substantial numbers of banks will be graded below that.

The calculation of these grades is to be based on "an insured depository institution's performance in meeting the credit needs of its entire community, including low- and moderate-income neighborhoods," *without any reference to the safety and soundness of those practices.*[46] The provisions on the rating system do not detail further the criteria for evaluating banks' performance in meeting the credit needs of their communities, but the FRB's written evaluations of the CRA performance of specific banks must place "special emphasis on the insured depository institution's record of serving the housing credit needs of low- and moderate-income persons, small business credit needs, and small farm credit needs."[47] Similarly, other provisions require the collection of "performance data" by the federal regulatory agencies regarding:

> (1) Housing loans in low- and moderate-income neighborhoods or equivalent areas.
> (2) Small business and small farm loans.
> (3) Financial investments in and contributions to local community development or redevelopment projects or entities . . .

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[44] Letter of Alan Greenspan to the Honorable Fernand J. St Germain, July 21, 1988 (emphasis added). In effect, H.R. 5094 would replace the current scheme of regulatory evaluation of banks' good faith efforts to meet community credit needs with specific, mandated financial and service commitments.

[45] H.R. Rep. No. 822, at 129.

[46] H.R. Rep. No. 822, at 38 (H.R. 5094, section 405, adding proposed CRA section 810(a)(1)).

[47] *Id.* (H.R. 5094, section 405, adding proposed CRA section 809(b)(2)).

> (4) Participation in governmentally or privately sponsored loan insurance, guarantee, or subsidy programs for housing, small businesses, or small farms.
> (5) The scope of efforts to market housing and small business loans in low- and moderate-income neighborhoods and minority neighborhoods.48

The effect of this system can be fully evaluated only in the context of standards set for banks and bank holding companies to engage in various activities. Under H.R. 5094's proposed amendments to the BHCA, a rating of "good" or "excellent" is required for bank holding companies, or their subsidiaries, to engage in virtually any nonbanking activity for third parties, including, for example, industrial banking, various trust company functions, financial advice, leasing, community development, data processing, certain insurance and underwriting activities.49 If a bank or bank holding company's rating is "average," the FRB must reject the application, unless the bank or bank holding company choses to proceed through the complex "preliminary approval" process, which requires commitments to increase the company's rating to a 1 or 2 and a continuing review process lasting at least 2 years.50

Thus, because the rating system is comparative and only above-average performance is sufficient to permit a banking entity to expand, the FRB has concluded, "In effect, this requires an institution seeking to expand to ensure that the resources it devotes for community reinvestment, including particularly housing to low- and moderate-income persons and small business and farm loans and related activities, are greater than those devoted by its peer group, thereby creating an escalating system of credit allocation for these particular loans."51 Individual banks are faced with an almost Sisyphean task in attempting to meet "above average" performance standards only to find that the "average" has changed due to the cumulative efforts of the industry.

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48 *Id*. at 37 (H.R. 5094, section 405, adding proposed CRA section 808(c)). This concentration on specific types of lending and other activities has led the FRB to conclude: "the specified types of lending covered by the report (generally housing loans in low- and moderate-income areas, small business and small farm loans, and related community development projects) in combination with the proposed requirements of the CRA evaluation and comparative rating system would tend to have the unintended effect of *mandating specific and increasing lending requirements in order to attain a satisfactory rating*." Staff Comments, *supra*, at 17.

49 H.R. Rep. No. 822, at 22-27 (H.R. 5094, section 403, adding proposed Bank Holding Company Act ("BHCA") section 11(a)).

50 *Id*. at 27-28 (H.R. 5094, section 403, adding proposed BHCA section 11(b)).

51 Staff Comments, *supra*, at 3.

While the House Report contends that the bill "would not rule out a high percentage of banks rising to the 1- and 2-rating levels" "under an industry-wide improvement in CRA performance," by definition the "average" bank still would be incapable of meeting the constantly increasing industry standards, no matter how much low-income lending it did. This apparently was the intent of the authors of the CRA provisions. As Representative Kennedy stated upon the introduction of those provisions in the House: "Under our bill [incorporated into H.R. 5094], the inflated ratings of the present would have to be scaled down to conform to a comparative rating system. Not all banks can be 'above average,' so the regulators will have to make decisions about which banks perform better than others. Only the best should be allowed to get involved in non-banking activities and interstate banking."[52]

Thus, there can be no doubt that the scheme imposed by H.R. 5094 is one of credit allocation. In effect, banks will be required to undertake certain types of lending or be forbidden from most normal avenues of growth. This flies in the face of Congress' decision to allow the free market determine the best allocation of credit in this country, and even may endanger the safety and soundness of many financial institutions.

B. Making Banks Uncompetitive

Although H.R. 5094, like S. 1886, originally was intended to benefit consumers, business, and state and local governments by increasing competition in investment banking services, Title IV ensures that banks will not be competitive in those areas. Title IV ties the exercise of any new powers under the Act to an above-average rating with respect to credit and deposit services to low- and moderate-income neighborhoods. Thus, unlike non-banking firms who engage in various securities and bank-like activities without the burdens imposed by H.R. 5094, banks that wish to engage in these activities will carry the additional cost of stepped-up CRA compliance. Obviously, these additional burdens will be reflected in the cost of the securities and other services banks can offer to consumers, thereby making the bank products less competitive against those offered by securities firms.

These costs include not only the burden of credit allocation to less productive assets, but also the substantial costs of regulatory compliance. For example, the additional delay created by the 45 day public notice requirement will nearly double the approval time for routine bank holding company applications. "This will needlessly raise the cost to bank holding companies of transactions requiring Board approval under the BHC Act and could have effects adverse to the public interest."[53] Other costly and burdensome provisions include (among many others): a 90 day notice provision to close a branch; a convoluted "preliminary approval" process for "average" bank holding company applicants which would involve no deadline on the granting of the initial preliminary approval, a review 180 days later, and a "final" approval 30 days after that (which, if not granted, requires the transaction to be unraveled), which final approval is subject to another review two years after the initial application; and, commitments by bank holding companies seeking to enter the securities field not to "diminish the availability of credit and deposit services for low- and moderate-income persons or small businesses or within low- and moderate-income neighborhoods or equivalent areas."54

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[52] Statement of the Honorable Joseph P. Kennedy II before the Select Committee on Aging Subcommittee on Housing and Consumer Interests, March 22, 1988, at 3.
[53] Staff Comments, supra, at 16.

Thus, unlike the original CRA which was not intended to add to the banks' burden of regulatory compliance, H.R. 5094 will increase significantly the red-tape, strangling not only the establishment of new deposit facilities, but also the establishment of nonbanking facilities, including, most notably, the establishment of qualified securities subsidiaries of bank holding companies. As the FRB has noted, these procedural requirements are in apparent conflict with the expedited 60 day notice procedure for nonbanking proposals established by Title I of H.R. 5094. More fundamentally, these provisions almost completely negate the purpose of Glass-Steagall reform -- allowing financial institutions to compete with securities and insurance firms -- by placing bank holding companies at a competitive disadvantage on entering those fields.

C. *Burdening the Regulators.*

Banks and bank holding companies are not the only entities that would be overburdened by H.R. 5094. The FRB has called the regulatory morass created by that legislation "extremely complex, difficult, if not impossible, to administer and disproportionately expensive."55 One cause of this complexity and expense is the fact that the FRB has been given virtually complete responsibility for implementation of the Act, despite the fact that an institution's primary regulator generally will be more familiar with the institution's CRA compliance record. The pressing nature of this unnecessary duplication of regulatory responsibility may be understood by considering the requirement that the FRB prepare a written evaluation of the CRA record of every bank owned by a bank holding company that seeks to acquire another bank or bank holding company. The FRB warns:

> This requirement would place a considerable strain on the Board's resources and would *require the Board to divert resources from bank safety and soundness* in order to examine the CRA record of virtually every banking organization that submits an application to acquire another bank. There are at present over 14,000 banks in the United States, only 1,100 of which are currently subject to the Board's direct

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54 *See* H.R. Rep. No. 822, at 27-29, 46-49 (H.R. 5094, sections 403, 431-34, adding proposed BHCA section 11(d) and the Notice of Bank and Thrift Closure Act of 1988).
55 Staff Comments, *supra*, at 6.

> supervision and examination. The Board is not familiar with the operating history of many of these banks, which are currently examined and supervised by the FDIC or the OCC, or with the needs of many of the communities in which these other banks operate.56

Similarly, the OCC has stated:

> [H.R. 5094] would greatly increase costs for the OCC and the other regulatory agencies because of the extensive human resource commitment that would be required to meet the statutory requirements.
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> * * *
>
> The OCC would have to shift examiner resources from safety and soundness exams and bank analysts from other areas to handle the increased volume of examinations, evaluations, ratings, etc.57

Not only does H.R. 5094 add a complex and costly new burden on the FRB, it also creates an impediment to the agency's ability to pursue its other goals -- most importantly, maintaining the safety and soundness of the United States' banking industry. Indeed, as noted in the quotation from the FRB staff above, the complexity of the CPP provisions will force the federal regulators to divert scarce resources from supervising the fundamental safety and soundness of their regulated institutions. Like the FRB, the OCC has voiced concern on this issue: "The proposed statute would limit the OCC's ability to allocate resources to ensure the safety and soundness of national banks."58

Moreover, specific provisions of the Act further hinder the regulators in this regard. For example, the section dealing with office closings requires the FRB to deny an application if the applicant has engaged in a pattern of acquiring, chartering, opening or closing federally insured depository institutions or deposit facilities in a manner that tends to exclude low- and moderate-income neighborhoods or equivalent areas. Thus, the FRB is foreclosed from weighing this factor

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56 Staff Comments, *supra*, at 12-13 (emphasis added).
57 Letter of Robert L. Clarke, Comptroller of the Currency, to the Honorable Chalmers P. Wylie, July 22, 1988, at 4. Such regulatory overkill in a time of fiscal hardship is compounded throughout Title IV, including, for example, the creation of new "consumer divisions" in each federal regulatory body. We have heard no mention yet of the source of the money that will be needed to fund these divisions.
58 *Id.* This is scarcely the time in our nation's history to substitute the narrow goals of H.R. 5094 for the critical roles those agencies and the banks they regulate must assume to keep our economy healthy.

against other important elements of the convenience and needs of the community or a variety of financial, managerial or competitive factors that may be relevant. It must subordinate the critical standards of financial health by which financial institutions should be judged to narrow considerations of the needs of certain aspects of the community.

D. Lack of Justification for Imposing Additional Restraints on Bank and Bank Holding Company Activities

In the rush to saddle the banking industry with the burden of social policies the government has been unwilling to fund, few have stopped to consider the justification for singling it out. Relying on the catch phrase that banks have an "obligation" to "reinvest" in the community, proponents of a stronger CRA have not questioned the continuing validity of that statement. As mentioned at the outset, however, the "obligation" to reinvest in the community has clear conceptual underpinnings, many of which no longer apply in the case of banks and most of which never applied to holding company activities.

As Senator Proxmire made clear when he introduced the CRA in 1977, the underlying premise of the CRA was that "[a] public charter for a bank or savings institution conveys numerous benefits and it is fair for the public to ask something in return."[59] Primary among the benefits that were said to give rise to the obligation to reinvest was the fact that in 1977 banks still had a virtual monopoly on deposit-taking from the general public. If the federal government enables banks to extract funds from a community at a regulated cost, it was argued, the federal government also can require that some of the benefit of those low-cost funds get reinvested into the community.

While that argument may have had a superficial attraction in 1977, the explosion of bank deposit substitutes since the late 1970's and the deregulation of the banking industry dramatically has altered the presumptions on which this argument is based. Banks now must compete against aggressive money market funds, mutual funds, nonbank banks and a host of other deposit substitutes, for the dollars of depositors. Because of this, the cost of deposited funds, measured by the interest rates paid to depositors, no longer are set at artificially low rates. Instead, Congress has decided to let the free market set the price of deposit funds (except for demand deposit accounts), so that banks are able to compete to offer depositors the best rates. Thus, banks' cost of funds have risen with new competition for the depositor's dollar. In sum, deregulation has dramatically decreased the uniqueness of the deposit-taking franchise. An important part of the argument that carried the day in 1977 should no longer do so. If there is a substantial lessening of the comparative benefits to the bank deposit-taking franchise vis-a-vis nonbank deposit-taking enterprises, there can be no justification for asking banks to make loans that no other commercial entity would make.

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[59] Hearings on S. 406, supra, at 1.

Moreover, H.R. 5094's burdens go well beyond the deposit relationship by exposing bank holding companies to the unreasonable costs and delays in the pursuit of nonbanking activities. In considering a bank's application for new deposit facilities, it made sense for regulators to consider the applicant's record in attempting to meet the credit needs of its community. When a holding company seeks to enter the securities business or engage in other non-banking activities, however, the credit needs of the community related to the holding company's bank subsidiary should not be at issue. When this issue is viewed from the perspective of the alleged value of deposit insurance, the imposition of burden on a holding company, having no direct relationship whatsoever between the deposit base of its bank and the range or size of the holding companies activities, produces major distortions.

E. A New Formula for Misuse

Thus, as far as we have been able to determine, the only perceptible reason for bringing CRA compliance into issue when bank holding companies want to engage in nonbanking activities is to give protest groups another opportunity to interfere with the pursuit of productive activities in our economy, thereby reinforcing the credit allocation aspect of the bill. Indeed, not only can they interfere in the pursuit of a whole new category of activities, they also will have an augmented capacity for delay. By requiring 45 days for public comment on any application, plus additional time (up to 90 days if the application is contested), H.R. 5094 virtually assures that bank holding companies with even exemplary records will have to negotiate with protestors in order to avoid costly delays.

Moreover, the Act insinuates these protestors in other unprecedented ways. For example, several provisions of H.R. 5094 permit an institution to commit to improve its performance over the course of two years. "Community and consumer groups" are given the opportunity to testify at the evaluation of an institution's compliance with its commitment at the end of those two years, yet the institution itself and other potentially interested parties (e.g., small businesses, farms, local governments) apparently have no such privilege.[60] In addition, those same groups must be consulted during the FRB's yearly review of the CRA performance rating system, yet no other parties are given that right.[61]

H.R. 5094 even contains the novel and unwarranted concept of a federally mandated "consumer" watchdog group to oversee federal regulators. These "Community Review Boards" would be created by each Federal Reserve Bank and would be comprised of 4 representatives each from (a) financial institutions, (b) "community organizations," (c)

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[60] H.R. Rep. 822, at 28 (H.R. 5094, section 403, adding proposed BHCA section 11(b)(6)).

[61] H.R. Rep. No. 822, at 39 (H.R. 5094, section 405, adding proposed CRA section 810(a)(5)).

"consumer groups," and (d) "civil rights organizations." 62 Thus, community "input" into the bank regulatory process appears to have blossomed into virtual control for protestors. Undoubtedly the grant of these new powers to the same groups that have been so successful already at using the CRA to stall legitimate business transactions will result in further extortion from the banking industry.

IV. CRA Refinement

The foregoing analysis underscores in detail the reasons for general industry opposition to H.R. 5094. In terms of scope, rationale and effect, the CRA provisions of the bill are unprecedented, unjustifiable and unworkable.

As we stated earlier in our testimony, however, our views as to the irreparable nature of this aspect of H.R. 5094 do not preclude our support for certain refinements to existing law. Specific refinements which we have advocated in the past (and continue to support) include:

(i) mandatory interagency uniformity with respect to data gathering and reporting requirements (if any) as well as with respect to examination procedures and rating standards,

(ii) regulatory studies of community financial services needs which would assist the private sector in assessing and identifying specific community service opportunities, and

(iii) maximum time limits on CRA-related public involvement during the application process.

To these recommendations, we would respectfully submit that the following options merit the Committee's consideration:

(iv) regulatory studies of the extent to which secondary market underwriting practices (e.g., HUD, Freddie Mac, Fannie Mae, S.B.A., etc.) may frustrate bank lending for low- and moderate income housing, community development and small business purposes; such studies should focus also on the particular impact of private mortgage insurance underwriting practices on bank mortgage lending and might also address disinvestment by non-bank financial services providers, including insurance companies, securities firms, mutual funds, pension funds and similar corporate money managers,

(v) subject to satisfactory resolution of the concerns expressed below, some form of public disclosure of the regulators' rationale for the assigned CRA rating,

(vi) advance public notification of branch closing plans, and

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62 Id. at 41-42 (H.R. 5094, section 412).

(vii) inclusion in any regulatory laundry list of CRA assessment criteria the voluntary provision of basic banking and/or government check cashing services as well as the proactive activities of a bank's holding company affiliates.

A. Interagency Uniformity

Uniform interagency protocols concerning the CRA performance data, conducting CRA examinations and rating CRA performances would provide much needed guidance to depository institutions as to performance expectations. It would also address concerns involving interagency consistency and the comparability of the CRA ratings rendered by different regulators. The Federal Financial Institutions Exam Council (FFIEC), comprised of representatives from the various federal regulatory agencies, would be a logical coordinating group.

B. Regulatory Study of Community Financial Services Needs

An oft cited criticism of existing law by both consumer groups and the banking industry is the absence of particular guidance as to the needs CRA is designed to address. Indeed, one confidential source and prominent CRA authority has suggested that the law is "Kafkaesque" in the sense that bank's are forever defending themselves from charges of a crime which is never quite defined.

We do not propose that legislative or regulatory criteria should specify in detail the CRA obligation of financial institutions. This would defeat the purposeful flexibility in existing law which acknowledges the varied needs of different communities. But we do believe that it is the appropriate role of government to aid the private sector in identifying community financial services opportunities which can be addressed to the benefit of all concerned.

Again, the FFIEC would be a logical coordinating body for such studies which could be subcontracted to universities and other qualified research groups.

C. Maximum-Time Frames for Public Involvement in CRA-related Comment and Hearing Processes

A major industry concern with respect to existing law is the open-ended nature of public participation in regulatory processes. Existing temporal guidelines generally provided that public participation must be permitted for specified minimum periods of time (i.e., the public comment period). Maximum time-frames are not mandated, however.

The absence of these latter limitations appreciably undermines the process of public involvement by discouraging concrete preparations and focused debate. This, in turn, tends to foster a non-productive level of frustration on the part of both industry and consumer participants, especially in the protest situation. Indeed, it is this feature that permits the community group abuses of CRA outlined above.

If the CRA exam and rating processes are satisfactorily reformed as outlined above, the scope of concerns to be addressed through public involvement in all CRA-related comment and hearing processes should be narrowed appreciably. If the ratings are perceived to be comparable and accurate and community service opportunities have been defined, there should be little to discuss when grades are good and specific issues to address if grades are bad. Maximum time frames should in no way infringe upon the public's interest in such a context.

D. Regulatory Studies of the Impact of Non-Bank Underwriting and Disinvestment Issues

The significant role that secondary market and collateral insurance considerations play in a bank's lending and investment strategies cannot be overemphasized. Simply stated, assets and investments which are readily transferable and capable of prompt liquidation provide financial institutions the flexibility and protection necessary in today's highly competitive and often volatile marketplace. The growing interest in asset or receivable securitization in the banking industry exemplifies the strategic significance that the underwriting practices of non-banks may play in a bank's investment decisions. The advent of a "risk-based" system of bank capitalization will further heighten the significance of these factors.

Another area over which banks have little control but for which propositions such as H.R. 5094 seem to hold them increasingly accountable, is community disinvestment by competing non-bank financial services providers, such as insurance companies, securities firms and other deposit-like service providers and money managers. This issue must be addressed if CRA is not to become a defacto substitute for responsibilities rightfully shared by all enterprises which benefit from the community's investments in their activities.

E. Some Form of Public Disclosure of the CRA Rating Rationale

This is a highly controversial issue which tends to find significant disfavor within the regulatory agencies, unease within the industry and strong support by community groups. H.R. 5094 provides for public disclosure of the commencement of the CRA examination process, the CRA rating and the written regulatory evaluation upon which the rating is based.63 This is clearly overkill and as such, totally unsupportable.

The regulatory agencies are concerned that the disclosure of the numerical CRA-rating may be confused with a statement of the institution's financial condition (i.e., the camel rating). They are also troubled by the notion of public interference, even intimidation in

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63 H.R. Rep. 822, at 37-38 (H.R. 5094, section 405(a), adding proposed CRA sections 807, 808 and 809).

the CRA-examination process. Finally, they are concerned that public disclosure of the specific examination reports underlying CRA-ratings could subject their decisions to challenge under the Administrative Procedure Act, 5 U.S.C. section 101 et. seq., and/or in the courts.

CBA shares these concerns. However, we do believe that there may be merit in some form of public disclosure of summary conclusions concerning an institution's CRA-rating when it is rendered.

This would provide interested persons a more timely opportunity to express their concerns as to an institution's record than is accorded by current law. It could help streamline a subsequent application process by focusing debate. Finally, it would justify time limits on public involvement at the application state by providing more CRA-related information to interested persons at an earlier point in time. This should facilitate advance preparations and negotiations at the application stage.

F. Advance Public Notification of Branch Closings.

CBA acknowledges the customer inconvenience that is occasioned by the relocation or closure of banking facilities. For this reason, we would support some form of advance public notification of planned branch closures, such as the posting of notices on the site of the facility being closed.

Some consideration might be extended to supporting the inclusion of such notice in branch customer account statements, provided that disclosure is largely discretionary in content and can be dispensed with in the instance of emergency acquisitions under regulatory authority.

Because the branch closure notification requirements in H.R. 5094[64] greatly exceed these basic guidelines, however, CBA opposes them.

G. CRA Consideration of Voluntary Basic Banking and Government Check Cashing Services and Affiliate CRA-Activities

The first four subtitle's of Title IV of the House bill are, in effect, a radical expansion of the CRA into a series of specific financial services entitlements. For this reason alone, H.R. 5094 is unacceptable.

This is not to say, however, that basic banking, government check cashing or other community services rendered by a bank or its holding company affiliates, could not be considered in the context of a CRA examination. Indeed, credit (or criticism) may well be due under CRA where a community need for such services can be established and a bank has (or has not) addressed that need.

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[64] H.R. Rep. No. 822, at 46-8 (H.R. 5094, Title IV, Subtitle D)

Although this is a far cry from the statutory mandate of specific services outlined in H.R. 5094, we respectfully submit that this is the more appropriate inducement to private sector proaction, especially in view of the unprecedented nature of the entitlement prescriptions in Title IV and the absence of a record supporting the need for such services.

VI. Basic Banking And Government Check Cashing

Title IV, Subtitle C of H.R. 5094 65 contains a provision that would require all depository institutions to offer a basic financial services account and to cash government checks for persons who register with the institution under this account.

Under this provision, the basic banking account would have the following features:

o available to individuals who have $1000 or less on deposit;

o for which service charges and fees for routine transactions can not exceed a minimal amount;

o with a minimum opening or balance requirement of not more than $25;

o that allows at least 10 checks or other withdrawals per month;

o that shows account activity via a detailed monthly statement or a passbook;

o that has no requirement for the account holder to exclusively use automated teller machines or other nonteller services;

o which may be closed, after notice, due to repeated overdrafts or fraudulent activity;

o no other account relationships required.

In addition to this basic banking account, an institution must make available, through this account, government check cashing services. The following parameters are outlined in H.R. 5094 for the cashing of government checks:

o the government checks to be cashed could be for no more than $1500;

o a fee of $2.00 could be charged to cash each check;

o customers could designate as many as three branches or offices at which he or she could cash checks;

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65 H.R. Rep. No. 822

o there would be no minimum opening or balance requirement for this account;

o Government checks are defined as any check issued by the United States, an in-state agency of a state, or any in-state agency of a local government.

The Consumer Bankers Association's positions on government check cashing and lifeline banking are well documented. During hearings last May before the Senate Banking Committee's Subcommittee or Consumer Affairs, CBA stated its opposition to any mandatory requirements that depository institutions provide such services.66

CBA and its members continue to oppose any legislative provision that sets specific bank policy across the board, for all depository institutions, on such proprietary business issues as the form and pricing of product offerings. A depository institution makes a decision on whether to offer lifeline or check cashing accounts by considering a number of factors that are unique to that institution: for some banks for example, the risk of fraud is significant while for other institutions it will likely be minimal. Because there are a great number of individual institutional factors that must be taken into account before a depository institution can offer such a service, it is impractical and indeed irresponsible to require that all institutions provide a uniform product or service.

The member institutions of the Consumer Bankers Association understand Congress' desire to improve access to check cashing services for elderly, low income and other needy individuals. We question, however, whether mandating lifeline or government check cashing services is the most appropriate way to meet this need.

Check Cashing Position

It is asserted that one of the best ways to bring individuals who are "unbanked" into the banking system is through "lifeline" or basic banking accounts designed to be accessible to and meet the needs of low and moderate income people. The basic banking account outlined in H.R. 5094 represents one approach to this type of account, but certainly not the only approach.

Depository institutions across the country are offering basic banking accounts in ever increasing numbers. Currently, more than half of the commercial banks in the US offer such accounts. A major problem with mandating that institutions provide basic banking accounts is that of defining such accounts. It is entirely possible that many

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66 Please refer to the testimony of Mr. Alan Heuer on May 18.

institutions may currently offer basic banking or lifeline accounts which are targeted to low income people, but which do not fit into the parameters outlined in H.R. 5094. Those institutions would have to redesign their accounts in order to be in compliance with H.R. 5094.

The CBA opposes mandating that banks offer lifeline accounts, and we most strongly oppose mandating the specific parameters of such accounts.

While the current House provision represents an improvement over previous check cashing proposals, CBA opposes this requirement as currently drafted. Mandated check cashing services are unnecessary and redundant in the context of H.R. 5094 because any person who has a lifeline account is a customer of an institution and would therefore have access to the same check cashing services offered to all other customers. This consideration aside, our concerns about fraud and operational expense still stand. The limitations on the types (federal and in-state and local) and the amount ($1,500 or less) of government checks that are in H.R. 5094 are significant steps in the right direction, but do not go far enough. Institutions should be allowed more discretion to design accounts that will fit their needs and those of their customers. Any provision that does not allow a bank, thrift or credit union to take into consideration its particular circumstances when developing a specific customer policy is a threat to safety and soundness.

If Congress deems it necessary to act in these areas, however, it is essential that it formulate policies that are protective of the interests of consumers and banks alike. One such policy initiative is the direct deposit option, along the lines of the one contained in S. 2110. Although direct deposit is still an option for the future for many of our smaller, rural institutions, we would like to see it encouraged wherever possible, particularly in conjunction with a lifeline account that is used for the purpose of cashing government benefits payments.

There are many reasons why we believe that direct deposit of government benefit payments should be encouraged. From both the depository institutions' and the issuing agencies' perspectives, direct deposit virtually eliminates problems with fraud and theft. This has certainly been the case in New York City, where losses on city issued public assistance payments were reduced significantly when the city entered into an electronic funds disbursement system with Manufacturers Hanover Trust Co. and local check cashers. Direct deposit is also less expensive and more efficient than paper checks. In areas where direct deposit has been mandated as the method of payment for government benefits, such as Ramsey County, Minnesota, recipient approval has been as high as 88%. Technologically, we are moving towards a direct deposit society.

Losses from check forging schemes and stolen checks, while difficult to predict, will undeniably be higher in some parts of the country than in others. Allowing banks in high risk areas to choose the direct deposit option enables these institutions to greatly reduce this risk. Requiring them to also offer the check cashing service would virtually negate the benefits of direct deposit in terms of fraud and stolen check losses. Such losses are at this point an unquantifiable but nevertheless very real problem. The impact of the Expedited Funds Availability Act on the incidence of fraud has yet to be determined and we would like to see these regulations in place for awhile before cashing of government checks for noncustomers is mandated.

In addition to the benefits to the agencies issuing the payments and the depository institutions, direct deposit is also beneficial to consumers. This method of payment vastly reduces the likelihood of a check being of stolen or lost, and such payments are more easily and quickly traced if they happen to get "lost in the system".

VII. Expedited Funds Availability

The Expedited Funds Availability Act (EFAA) 67 went into effect September 1, 1988. At the time S. 1886, The Proxmire Financial Modernization Act (Act) of 1988 passed, Congress was aware of some of the problems related to making funds available on next-day items. As a result, the Act amended the EFAA.

Subsequent to passage of S 1886, the Federal Reserve Board as well as the industry asked the House to include additional amendments and we ask that you include the following amendments found in section 472 of H.R. 5094.

The amendments would permit financial institutions to:

- Apply the exceptions to checks that must be given next-day availability;

- Permit a depository institution to provide next-day availability of funds for checks only if they are deposited at manned teller facilities;

- Clarify that the liability rules apply to all entities participating in the payments system; and

- Provide flexibility in certain civil liability provisions.

The first amendment expands the applicability of the exceptions to checks that must be given next-day availability. Under the Act, a depository institution must make the entire proceeds of certain check deposits available for withdrawal at the start of the next business day following deposit, irrespective of the amount of the deposit; or the fact that the check being deposited had previously been returned unpaid; or of the fact that the institution has reasonable cause to believe that the check being deposited is uncollectible. The

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67 Title VI of Pub. L. 100-86

exceptions to the schedules, which are available for other check deposits, should also apply to next-day checks in order to control the risks of fraud that may result from the inability to use these exceptions.

The second amendment would permit a depository institution to provide next-day availability for Treasury and "on us" checks only if they are deposited at staffed teller facilities. Congress required that cash and all other deposits be deposited at staffed teller facilities in order to receive next-day availability, because it recognized the difficulties in verifying the contents of deposits at ATMs and other unstaffed facilities in time to update a depository institution's books so that it could make funds available for withdrawal at the start of the next business day. These same considerations should apply to Treasury checks and "on us" checks.

The third amendment would allow depository institutions to issue a single notice to customers who have repeatedly overdrawn their accounts, to customers who have checks redeposited, and to customers who make a deposit of more than $5,000. Under the Act, whenever any exception to the schedule is invoked, the depository institution must notify the customer that the exception is being used. While such individual notices may be appropriate in the case of the reasonable cause exception, they are not appropriate for the large-dollar exception, the redeposited check exception, or the repeated overdraft exception. These exceptions may be invoked for: all deposits over a specified amount (in the case of the large-dollar exception); all checks covered by the redeposited check exception; or all deposits during some time period (in the case of the repeated overdraft exception). In these cases, it would be more efficient and less costly to depository institutions if they had the flexibility to tailor the notice requirement to the exception invoked. The proposed amendment would accomplish this result. For example, under the amendment a single notice to repeated overdrafters or customers making a deposit of more than $5,000 - describing the special schedules applicable to the account for the time that the exception is in effect - is more appropriate.

The fourth amendment would clearly permit the Federal Reserve Board to allocate liability for losses among all entities in the payment system. Other entities besides depository institutions are involved in the collection and payment of checks. These entities include states and their political subdivisions, which often issue "warrants" drawn directly on the states or political subdivisions themselves. These warrants are often used to pay employees, vendors, pensioners, and those receiving public assistance; they are thus very important to the recipients. Section 611 (f) does not clearly authorize the Board to allocate liability for losses, such as those resulting from the mishandling of a returned check, among entities including states or their political subdivisions. The amendment would not permit the special class action and punitive damage awards against these entities.

The fifth amendment would delay by four months the implementation of the civil liability sections of the Expedited Funds Availability Act as it applies to certain sections of the Act relating to the disclosure requirements. It does not affect the effective date of civil liability as it applies to the availability schedules. Banks must make funds available within the time-frames required by the statue. The amendment would give financial institutions four months during which they could ensure that they have complied with the disclosure requirements.

The Federal Reserve has been very efficient in publishing for comment proposed regulations, but proposed regulations are necessarily complicated and voluminous. The final regulations were only published in May, 1988, leaving little time to review the regulations and implement all the extensive changes demanded by the Act and the regulations by September, 1988.

The amendment is consistent with the spirit of the Act as liability still applies with regard to the availability schedules. In addition, during this limited four month period, the Federal Reserve Board has full authority to address noncompliance of these sections if appropriate.

Additional Amendments

Section 471 of H.R. 5094 would have changed the original treatment of credit union payable through drafts under Regulation CC, the Regulation which implements the EFAA. Subsequent to passage of H.R. 5094, however, the Credit Union National Association, et al. prevailed against the Federal Reserve Board in a suit on this issue and the Federal Reserve Board amended Regulation CC to reflect the court decision.

As a result, this amendment is no longer necessary and should be deleted. The treatment of credit union share drafts (a share draft is similar to a check drawn on a credit union rather than a bank) under Regulation CC, however, should be addressed and the Federal Reserve Board should be given clear authority to treat credit union share drafts the same way that all other checks are treated consistent with the goals of the EFAA.

The Expedited Funds Availability Act requires financial institutions to make funds available within certain time frames. It distinguishes local from nonlocal checks and permits a longer time for nonlocal checks.

The Act defines local and nonlocal based on whether or not the bank that receives the check and the bank that pays the check are in the same Federal Reserve Check Processing region. If both are in the same region the check is local, if not the check is nonlocal.

After much deliberation the Federal Reserve Board decided that the only practical method to determine whether a check is local or nonlocal was to use the routing number [which is encoded on each check in magnetic characters (MICR)] of the check which indicates the check processing region and the bank that pays the check. Financial institutions use efficient computer-controlled automated sorting machines that read and sort checks based on the routing number. The automated forward collection system permits the expeditions processing in checks, one of the main goals of the EFAA. The use of the routing number is an integral part of the process.

The credit unions, however, were unhappy with this result because most of their share drafts are payable through a designated commercial bank that is located in a different Federal Reserve Processing region. These share drafts are encoded with the routing number identifying the commercial bank, not the credit union. Accordingly, most of the payable through-drafts are sent to the payable-through bank, not the credit union for collection, and are considered nonlocal.

The Credit Union National Association (CUNA) sued the Federal reserve Board because it believed that if the bank where the check was deposited and the credit union on which the draft was drawn were in the same region, the check should be treated as a local check and accorded the shorter availability time for local checks under the EFAA. Because of certain definitions in the EFAA, the court sided with CUNA. This decision flies in the face of one of the goals of the EFAA - i.e., the improvement of the check collection system - and ignores and impedes efficiencies in the current system. Not only does it require new and confusing disclosures, but it also requires that share drafts be processed manually - slowing the check collection process. If the routing number cannot be used, the high-volume, high-speed computer-controlled automated sorting machine may not be used.

By treating a share draft as local, even though it is paid through a nonlocal bank, banks are at a higher risk - they may be making funds available before the checks have completed the check collection process.

We ask that you amend the definitions in the EFAA so that the Federal reserve Board clearly has the authority to treat share drafts in a manner consistent with the goals of the EFAA.

Congress recognized that the EFAA itself could increase fraud losses for financial institutions. As a result, exceptions from the schedule for new accounts, large dollar deposits and others were included in the EFAA. We believe that the new account exception should be extended from thirty days to six months. Historically, financial institutions have considered new accounts risky and have imposed restrictions on items deposited into these accounts. New accounts pose risks because the financial institution has had no experience or relationship with these account holders on which it can assess their ability or desire to manage their accounts. More importantly, new accounts are often involved in check kiting schemes, because individuals who are knowledgeable of the law and the check collection system use their knowledge to withdraw funds before the bank discovers that the checks are uncollectible. The extension will permit financial institutions to monitor new accounts activity for a reasonable amount of time.

VIII. Other Concerns

A. ECOA Amendments

Section 804 of H.R. 5094 would amend the Equal Credit Opportunity Act, 15 U.S.C. section 1691 et seq. ("ECOA") to prohibit credit discrimination on the basis of academic pursuits. We are advised that the conduct of a certain credit card issuer, which favored business over liberal arts majors in a springtime card promotion, is the target of this provision.

CBA believes that the conduct in question was an aberration. It was confined as far as we can determine to a single institution. Further, that institution was quick to respond to consumer complaints by promptly discontinuing the policy.

The episode has received substantial media play across the country. CBA has alerted its members as to the Congressional sensitivity to this matter. We do not, therefore, anticipate a replication of the policy.

CBA would also observe that certain postsecondary education lending policies presently promoted by both the Congress and Administration cut directly against the expansive scope of this proposal. Specifically, initiatives designed to discourage government subsidized lending for schools with unreasonably high default rates may run afoul of this ECOA proposal.

Finally, we respectfully submit that the policy in question, while perhaps lacking a desirable rationale, simply doesn't rise to the level of a deprivation of civil rights. In contrast, this is precisely the focus of the laundry list of prohibited discriminations under ECOA ("race, color, religion, national origin, sex, marital status, or age..." - and academic pursuit?). Further, the standard in question, framed in part as a subjective intention, is dangerously vague given the severe penalties which entail for ECOA violations.

In light of the above, and with no intention of defending the common sense or business proprietary of the policy in question, CBA respectfully urges this Committee to reject this matter.

We also note that subtitle H of H.R. 5094 68 would restrict the authority of the Board of Governors of the Federal Reserve System to provide for exemptions from some of the complex disclosure, notification and recordkeeping requirements under ECOA. The provision focuses on business purpose credit which always has been, and will continue to be, subject to ECOA's prohibitions on credit discrimination. It would require the Federal Reserve to presently re-evaluate this and other existing exemptions and to do so at least every 5 years.

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68 H.R. Rep. No. 822 at 63

CBA respectfully submits that this provision is premised on the mistaken impressions that existing law fails to prohibit wrongful business credit discrimination and that the Federal Reserve exemption is not subject to continued review. Neither view is accurate and, as such, Subtitle E is unnecessary.

B. Disclosure Initiatives

While acknowledging the Committee's request to limit our views to matters unique to H.R. 5094, CBA is compelled to express continuing reservations with respect to the volume and complexity of the disclosure requirements in H.R. 5094's deposit account and home equity loan initiatives.69 The consumer's ability to focus on pertinent investment and/or credit shopping information is severely threatened by the detail required by these provisions.

Also of particular concern is the Truth-in-Savings initiative's provision to non-customers of the full panoply of Truth-in-Lending-styled civil remedies. This is an unfortunate break with the Truth-in-Lending precedent. CBA respectfully submits that there is no legitimate rationale for offering such protection to non-customers. Financial institutions should not be exposed to the risk of substantial penalties for conduct involving persons who have not established an account relationship. How have such persons been harmed?

Conclusion

The Consumer Bankers Association supports the course upon which the 100th Congress is embarked due in large part to the Senate's initiative and leadership. With some exceptions, notably the insurance restrictions, S. 1886 is a blueprint for change that is both procompetitive and proconsumer.

The burdensome CRA and related entitlement provisions in H.R. 5094 skew this equation so severely as to render at least these portions of Title IV of the House bill irreconcilable with the Senate's actions and objectives. It is especially alarming that these ill-conceived and highly controversial provisions have come to be regarded as the chief threat to the concensus on financial modernization embodied in the Proxmire bill.

In this light, CBA must endorse the summary views of Chairman Greenspan:

> I cannot emphasize too strongly that the banking system is urgently in need of modernizing changes in its basic mandate to allow it to adapt to a changed competitive environment at home and abroad. Those changes are most effectively accomplished by Congress

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69 H.R. Rep. No. 822 at 49 and 55, respectively, (Subtitles E and F, Title IV)

The CHAIRMAN. Thank you very much, Mr. Kolesar.

Our next witness is Mr. Thomas Rideout, vice chairman of First Union National Bank of North Carolina, representing the American Bankers Association.

STATEMENT OF THOMAS P. RIDEOUT, VICE CHAIRMAN, FIRST UNION NATIONAL BANK OF NORTH CAROLINA, CHARLOTTE, NC, REPRESENTING THE AMERICAN BANKERS ASSOCIATION

Mr. RIDEOUT. Thank you, Mr. Chairman.

I appreciate this opportunity to discuss the consumer provisions of title IV of H.R. 5094 with you and the members of the committee.

Subtitles A and B of title IV contain complex CRA provisions intended to increase the volume of credit extended by banks to borrowers in low- and moderate-income communities. The provisions must be analyzed carefully, as they could dramatically affect the cost and availability of credit and deposit services in low- and moderate-income communities.

It is noteworthy that there have been no legislative hearings on them until today.

Mr. Chairman, the member institutions of the American Bankers Association support the purposes of the Community Reinvestment Act. We believe in community lending, lending for housing, lending for small-business growth, lending for farm operations, and lending for many other community purposes as well.

Our members are involved actively in community development and reinvestment in cities like Chicago, Philadelphia, Des Moines, Atlanta, and Washington, DC. We live in and earn our livelihood from our communities and it is in our self-interest to keep them strong and vital.

Along with thousands of banks across the country, my bank, First Union, is working hard to meet the needs of low-income communities with specialized lending programs, basic banking services, and corporatewide involvement in CRA performance at all levels.

I would ask your permission, Mr. Chairman, to submit for the record a number of exhibits that document my full statement and speak to our CRA program.

The CHAIRMAN. Without objection, it will be received in the record.

Mr. RIDEOUT. Thank you very much.

PROVISIONS OF TITLE IV ARE UNACCEPTABLE

While the ABA supports the purposes of the Community Reinvestment Act, we must oppose the CRA provisions in title IV of H.R. 5094. They are unworkable and unacceptable for at least five principal reasons:

First, the provisions would link CRA obligations to bank holding companies' nonbanking activities. This is contrary to the original intent of CRA and inconsistent with the Bank Holding Company Act.

Second, the provisions would shift the mandate of CRA from requiring affirmative efforts "to help meet" low-income community credit needs on a sound basis, to requiring "special emphasis" loans to "meet" low-income, small-farms, and small-business needs—all of this without considering safety and soundness. The proposed scheme would lead to a permanent system of credit allocation.

Third, the provisions would alter CRA enforcement to rely heavily on community group protest. The original CRA was intended to help establish a constructive dialog leading to public and private cooperation. And I think it has. These gains and the growing momentum for cooperation would be disrupted by the encouragement of community group protest.

The impact is crucial. My institution, First Union Corp., files about 100 applications or notices per year, or 2 per week on average, that could be protested under the title IV CRA provisions. Most of these applications are now handled quickly, usually within a few weeks. Under the House CRA provisions, delays running to years, with enormous increases in attendant costs, are quite possible.

The CRA assessment factors are vague. Anyone can protest. An industry filing nearly 6,000 applications per year could be paralyzed.

Fourth, the provisions would require a costly data collection program that could not accurately portray overall community lending activity.

Fifth, and very importantly, the provisions would draw heavily on the limited examiner and enforcement resources of the banking agencies.

Subtitle C of H.R. 5094 requires depository institutions to offer basic bank accounts and government check-cashing services. A great many banks cash government checks today, and more than half of all banks offer low-cost accounts which are designed for their specific markets; 70 percent of large banks offer such accounts.

A great many questions need to be answered before required services are mandated nationwide that could significantly impact the profitability of branches in low-income neighborhoods.

I urge this committee to consider establishing a nationwide pilot or demonstration project involving depository institutions across the country. A project with broad participation, including consumer groups, would enable all of us to get the answers to key questions such as branch profitability, service types and levels, broad risk factors, paper check versus direct deposit, consumer needs and utilization, and local government-bank arrangements.

The views of the American Bankers Association on the other five subtitles of title IV are presented in my prepared statement and in more detailed form in the appendices to my statement.

I look forward to discussing these matters further and responding to any questions that you may have. Thank you for your attention.

[The complete prepared statement of Thomas P. Rideout follows:]

> and the future vitality of the banking system depends upon a demonstration that Congress is capable of taking the crucial first steps that will begin the process and establish the framework for future change. It would be unfortunate indeed if the steps that have already been taken this year that seemed so promising did not in the end produce concrete results.70

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70 Greenspan letter, supra, Note 2 4-5.

Statement of

Thomas P. Rideout

Vice Chairman

First Union National Bank of North Carolina

Charlotte, North Carolina

President-Elect

American Bankers Association

Before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

September 8, 1988

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5. Analysis of Subtitle F, Home Equity Disclosure

6. Analysis of Subtitle G, Expedited Funds Availability Amendments

7. Analysis of Subtitle H, Equal Credit Opportunity Act Amendments

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I. INTRODUCTION

Mr. Chairman and Members of the Senate Banking Committee, my name is Thomas Rideout. I am Vice-chairman of First Union National Bank in Charlotte, North Carolina, and President-elect of the American Bankers Association. I appreciate the opportunity to appear before you this morning on behalf of the American Bankers Association to testify on the consumer provisions of H.R. 5094, reported by the House Banking Committee on July 28th.

The American Bankers Association membership ranges in size from the smallest to the very largest banks, with 85 percent of its members having assets of less than $100 million. The combined assets of ABA members comprise about 95 percent of the assets of the commercial banking industry.

The consumer provisions of H.R. 5094 are contained in Title IV. These provisions deserve your very closest attention. They are complex and many are not well understood. Moreover if enacted, they could have significant unintended effects on the cost and availability of credit and deposit services to low and moderate income communities and on the operations of banks and bank holding companies.

Title IV of H.R. 5094 contains eight subtitles and may be the largest body of consumer legislation ever considered by Congress. Subtitles A and B would significantly alter the bank and thrift holding company acts and the Community Reinvestment Act. Subtitle C would require all depository institutions to offer "basic banking" accounts and cash government checks. Subtitle D would require national banks and federal savings and loan associations to provide profit histories and forecasts before closing a branch and to notify branch customers of the intended closing. Subtitles E and F respectively would impose "truth in savings" and home equity loan disclosure requirements. Subtitle G would amend the Expedited Funds Availability Act, and Subtitle H would amend certain record keeping and denial notice terms relating to commercial loans under the Equal Credit Opportunity Act.

Consideration of some of the legislation in Title IV has been quite limited. There have been no hearings on the legislative language in subtitles A, B, and D until today. This fact is critically important. Without thorough hearings involving all affected parties including consumer and community groups, federal agencies, state and local governments, and depository institutions, it is difficult to know precisely what problems need to be addressed and how to do so without unintended effects and unnecessary regulatory costs.

In addition to Title IV, the 100th Congress has considered other consumer legislation including the Credit Card Disclosure Act which is currently in conference and the Expedited Funds Availability Act which was passed in 1987. While each piece of consumer legislation is well intentioned, each carries with it a body of regulations and, of course, imposes a cost on the banking industry. For example, the Expedited Funds Availability Act as reported by the House Banking Committee in 1987 after extensive hearings was 37 typewritten pages long. The typewritten text of Federal Reserve Regulation CC implementing it was 647 pages long. I mention this not to reopen the funds availability debate, but to emphasize that these laws can impose real and substantial cost burdens and that concepts which may appear relatively simple legislatively can become very complex in the real world.

While no one current law or regulation alone poses an unmanageable burden, the cumulative effect of the growing body of laws, rules and regulations is quickly becoming overwhelming. The increased cost of compliance with these regulations has serious implications for the ability of the banking industry -- especially small banks -- to compete with other financial service providers who are not subject to the same rules. Perhaps more important, the increased costs of compliance must ultimately be paid by the consumers these laws were designed to protect. It is therefore very important that policy makers strike a balance between the actual benefits of each proposal and the costs of compliance.

Enacting Title IV will trigger an avalanche of new regulation. The cost implications are enormous. We urge this Committee to consider the implications of this legislation very carefully before imposing its costs on the banking industry and the public.

The position and concerns of the American Bankers Association regarding each of the subtitles of Title IV are summarized in my prepared statement and discussed in detail in the attached appendices.

II. SUBTITLES A AND B -- COMMUNITY BENEFIT AMENDMENTS

Subtitles A and B contain amendments to the bank and thrift holding company acts and to the Community Reinvestment Act (CRA) which are intended to increase the volume of credit extended by banks to borrowers in low- and moderate-income communities. These are generally referred to as the "CRA provisions." They must be analyzed carefully. There have been no legislative hearings on them until today, and they have far reaching implications -- the provisions would profoundly alter the intent and terms of the Community Reinvestment Act.

Mr. Chairman, the member institutions of the American Bankers Association support the purposes of the Community Reinvestment Act. We believe in community lending -- lending for housing, small business growth, farm operations -- lending for all purposes. And we believe in doing our share to revitalize low-income neighborhoods with sound, nondiscriminatory lending programs. We believe in community development because these are our communities. We live and work in them. We want them to be as strong and vital as possible.

While the American Bankers Association must oppose the Title IV CRA provisions for the reasons summarized below and detailed in Appendix 1, we are interested and prepared to discuss ideas to modify CRA to make it a better statute. We met for many hours with House Banking Committee Members and staff on this matter and are also prepared to work closely with Senate Members and staff to improve the Community Reinvestment Act.

Community credit needs are complex. I can attest to this from direct experience. My bank, First Union National Bank, does a needs assessment in each one of our market areas. We have found that there is great variation from market to market and in the communities that make up individual market areas.

In the comments which follow, I will first discuss the community lending problem as I see it, and give some examples of how First Union and other banks are working to meet low-income community credit needs. I will then discuss the terms of subtitles A and B, focusing specifically on four aspects that make them unworkable and unacceptable.

A. Community Credit Needs

The premise underlying the subtitle A and B provisions is that low-income communities can be revitalized by requiring banks to meet low-income community credit needs. This premise is inaccurate in two important respects. First, credit is only one aspect of community well-being; and second, banks are not the only suppliers of financial services -- in fact, banks are becoming an increasingly less important component of the financial services industry.

Credit availability undoubtedly plays an important role in community well-being, but the deterioration of inner city neighborhoods and rural areas is due to a number of interrelated factors. Lending is only one part of a very complex process of community growth, decline, deterioration, and rebirth. In this process bank credit is not the sole or even the principal reason for neighborhood deterioration or recovery.

The effects of other factors must be considered and weighed carefully. Decreases in federal government expenditures for low-income housing and community revitalization, cut-backs in federal small business loan guarantees, and declines in mass transit, job-training, and primary and secondary education spending levels have undoubtedly had an impact on the vitality of low-income communities. Also to be considered are broader demographic factors affecting borrowing preferences, rural community population levels, birth-rates in low-income communities, and foreign immigration.

Banks are not the only financial institutions receiving household and business funds needing to be reinvested. In fact, banks are receiving a declining share of total household and business savings and investment dollars. Of the total volume of funds flowing out of cities, towns, and communities and needing to be reinvested, only 34 percent now flows into banks; in the early years of this decade, banks received almost 40 percent.

Banking's role in providing credit is also decreasing. The market share of financial assets -- investments and loans to individuals, businesses, and government units -- held by banks has declined steadily over the past 15 years, falling from 40 percent in 1974 to 29 percent by March 1988. The share held by insurance companies, finance companies, mutual funds, securities firms and other nonbank financial firms climbed to 51 percent over the same time period. But none of these other financial service providers are covered by the current terms of the Community Reinvestment Act nor would they be covered by the subtitle A and B requirements.

In the past few months, there has been much publicity about charges of "redlining" by banks in Atlanta and other cities. I cannot comment on the circumstances in other cities, but my institution has offices in the Atlanta market and I can comment on the situation there. As I see it Atlanta is a good example of the complex interplay of demographic and financial factors in the credit makeup of a market area.

The Atlanta Journal-Constitution found that more home improvement loans were made by banks in "minority" neighborhoods than in "white" neighborhoods and that more mortgage loans were made by banks in "white" neighborhoods. The mortgage credit needs of the "minority" neighborhoods were being met -- but not by banks. They were being met by mortgage banking companies offering competitive low-downpayment, federally-backed mortgages.

The mortgage banking activities of the bank holding companies, however, were not included in the Atlanta Journal-Constitution's evaluation of bank CRA performance.

The Atlanta mortgage market is quite competitive. There are over 400 providers of mortgage credit listed in the Atlanta "Yellow Pages".

In Atlanta, banks were perhaps making more conventional mortgage loans in "white" neighborhoods than in "minority" neighborhoods. But is this pattern "redlining" which is a violation of the Equal Credit Opportunity and Fair Housing Acts, or a pattern contrary to the Community Reinvestment Act? Or is the pattern reflective of "minority" preferences for remaining in the same home for longer periods than "whites", resulting in greater demand for home improvement loans and a lower demand for home mortgage loans? Does it reflect a demand for mortgages that require lower downpayments than the conventional mortgages offered by most Atlanta banks? Or does it reflect better and more aggressive marketing on the part of the mortgage bankers competing with the banks? A more comprehensive understanding of the complex array of factors affecting community well-being suggests that the "minority/white" mortgage lending pattern undoubtedly reflects all these factors and probably many others, but it is not necessarily the result of bank resistance to reinvesting in "minority" communities.

But regardless of the causes of the lending pattern, banks want to do their share to help and have developed programs to do so. The letter and spirit of the Community Reinvestment Act mandates that banks make an affirmative effort to meet the credit needs of their entire service area and not exclude the needs of low-income communities. My bank, First Union, serves the Atlanta area, and we are making efforts to meet the needs of the low-income communities there as well as in other market areas we serve.

During May, 1988, First Union National Bank of Georgia announced its participation along with eight other Atlanta area banks in a $20 million Atlanta Mortgage Consortium. The purpose of this consortium is to provide reduced rate home loans to the residents of low and moderate income neighborhoods in Atlanta. This is part of a total of $65 million in special mortgage commitments also announced by the Atlanta bank at that time.

The Consortium will offer loans of up to 97 percent of appraised value, with no requirement for private mortgage insurance. Under this program, qualified borrowers may purchase a single family, owner-occupied home with a below-market, fixed rate loan set at one-half percent to two percent below standard 30-year fixed mortgage rates. No discount points are charged in this program.

In addition to participating in the Atlanta Mortgage Consortium, First Union has been providing an aggressive community reinvestment program through two specialized lending programs for low to moderate income people since it came to Atlanta in November, 1986. These programs are also available in other states served by First Union which include North Carolina, South Carolina, and Florida.

The first is known as "A Very Special Loan on the House" program. First Union offers unsecured special home improvement loans of up to $5,000, and secured home improvement loans of up to $15,000. These loans waive origination fees, offer special loan rates and underwriting criteria, and reward the borrower for timely payments by rebating 1.5 percent of all interest payments made in any calendar year. The program includes financing of closing costs and a waiver of normal loan fees.

In addition, First Union established a Minority Enterprise Loan Policy in 1973 and has continually updated it and implemented it in all of its banking states. This policy provides that any lending officer may approve a minority enterprise loan within his or her lending limit with the further proviso that in order for a minority enterprise loan request to be turned down the concurrence of at least two lending officers will be required. In addition, each regional office in our various states has access to at least one lending officer who is responsible for monitoring the availability of minority loan programs to assist the bank or minority businesses.

In conjunction with this policy, the bank offers business loans designed especially for small minority companies with annual sales of less than $5 million. A major enhancement to this program will be announced later this month.

First Union has also been most pleased to make available a basic banking account, known as "No Minimum Checking." This account permits ten checks per month with no minimum or average balance required. The account provides no charge accidental death insurance coverage of $1,000, and access to our 24-hour banking machines, access to instant credit reserve accounts, and a monthly detailed statement of account transactions. The monthly maintenance fee for this account is $3.00, with a 50 cents per check charge after the tenth posted check in any given statement period.

We are very actively exploring the introduction of a price differential if the customer uses direct deposit. For instance, if a customer were to sign up to have a Social Security check deposited directly to the account, the price of this service would be lowered.

In addition, First Union has several other programs which are vital to its community reinvestment efforts throughout its banking region. For instance, First

Union has for a number of years established a CRA undertaking or statement in every state in which it operates. These statements are a reflection of First Union's philosophy to serve all the needs of the communities which we serve, including low and moderate income neighborhoods, consistent with safe and sound banking operations. These statements are shared with interested consumer and civic organizations.

Additionally, we have developed a special CRA brochure with a tear-off response card which is in place at all of our approximately 750 branches. This program is purely voluntary. The purpose of this brochure is to inform our customers of our CRA efforts and to invite their inquiries.

Important among First Union's CRA efforts is our willingness to conduct community needs assessment studies in the metropolitan areas of the states where we conduct banking operations. The goal of these assessment studies is to determine the banking product and credit needs for low and moderate income groups and minorities within these areas. This helps us design useful products and outreach marketing programs for our various markets.

We stress outreach and marketing through our various subsidiary banks by using our best efforts to inform low and moderate income groups and minority businesses of our basic banking and lending programs and other services. For instance, we endeavor to employ minority advertising or marketing firms to assist in these efforts.

Some explanation of First Union's organizational approach to CRA on a system-wide basis will place these product and marketing initiatives in a useful context.

First Union's CRA involvement is directed by a corporate-wide steering committee consisting of top corporate officers as well as designated state officers responsible for CRA and compliance matters in each state. This committee concerns itself with establishing policy, discussing new product innovations, and monitoring CRA performance on a system-wide basis.

In addition to this senior committee, we are establishing in each state a self-assessment committee which not only conducts the self-assessment studies but tailor-makes product outreach marketing decisions in an attempt to reach low and moderate income consumers and neighborhoods. Line officers will be rotated to serve on these committees on a regular basis as a means to increase our overall staff experience and sensitivity.

In addition, First Union has in place a CRA coordinator in each of its four banking regions in Georgia, and a CRA coordinator for every city we serve. Line and staff officers fulfill this function. Once the effectiveness of this model is determined, it is likely to be implemented in our other states.

Other features of First Union's CRA effort include the development of a CRA training video which will be viewed by all employees throughout our four-state area. Our branch procedures and operating manuals stress compliance with CRA.

Both our corporate-wide and state committees interface regularly with the regulators. Approximately 35 people are involved in this compliance effort at First Union on a corporate-wide basis.

CRA training and awareness is also emphasized at First Union. The bank's credit training programs include information pertaining to its lending policies regarding low and moderate income groups and to minority businesses so that the appropriate personnel will be aware of the bank's objectives in this area.

As a part of our Consumer Associates training program, a full day is devoted to a discussion of our policies, goals and programs to serve the needs of low and moderate income customers and neighborhoods.

Finally, our personnel evaluation system for line managers and lending officers holds these personnel to be accountable for CRA results. The supervisors measure the success of each individual officer's outreach in meeting consumer needs. This evaluation incorporates the regulators twelve basic assessment factor and is consistent with First Union's CRA philosophy and policies.

With respect to overall management of our banks, First Union is in the proces of identifying individuals from low and moderate income groups, minority groups, o other community-involved groups to serve on local boards of directors and have placed many such individuals on such boards.

First Union also supports community development corporations and counseling services in a variety of ways. These latter groups assist low and moderate income borrowers and customers through the use of credit counseling and similar credit services which are offered by third parties.

First Union has also initiated a Quality Customer Service Program ("QCS") throughout its system. While this program is not directly related to the bank's CRA compliance program, it has many features which greatly enhance First Union Compliance under CRA. The QCS program is designed to provide each First Union employee with increased training and knowledge so that they will be able to better respond to and service the individual needs of First Union's customer in a manner that is unequalled in the banking industry. As a part of QCS, a new cross-cultural communication training course is presently being developed in the Bank which is specifically designed to teach employees how the empathize with cultural differences and to develop employee skills for building rapport and improving communications and relationships with customers of all backgrounds. This course recognizes differences of race, sex, age, religion, ethnic background, socioeconomic conditions and educational levels. The goal of QCS and this training program is to develop First Union employees who are able to effectively communicate with and serve the individual needs of all First Union customers regardless of who they are.

In addition to these efforts, many of our banks actively participate in an ABA-sponsored Personal Economics Program (PEP) designed to help educate the community about banks, banking services and personal financial management. These programs are run by local bankers and are offered in schools or to community groups requesting them. Last year, more than one-half million students received personalized instruction from local bankers who volunteered their time to teach students the basics of how to open and maintain a checking account, how to get a loan, and how to establish credit. Tina Zimmerman from our bank in Augusta personally reached more than 200 students with PEP presentations.

In addition to PEP, the American Bankers Association in 1973 established MINBANK Capital Corporation. MINBANK is a non-diversified, closed-end investment company that makes capital funds available to minority-owned banks. Since 1973, MINBANK has invested in 17 minority-owned banks across the United States. MINBANK is a profit-oriented business corporation as opposed to a non-profit or government supported organization. This is done to cover operating expenses and provide a return to investors, and importantly, to provide an equitable basis for the distribution of our funds among a number of banks.

First Union and the ABA are not alone. Banks and bank holding companies across the country are working with community groups to design innovative programs which will help their communities grow and prosper. Let me give you a few examples I have heard from bankers around the country.

One of the oldest lending success stories is in Philadelphia where the Philadelphia Mortgage Plan was created in the early 1974. This highly successful plan is the product of cooperation between local banks and neighborhood groups. It has resulted in more than 11,000 mortgage loans to low and moderate income residents. Each participating bank makes its own loans. The banks hold the loans they originate in their portfolio, enabling them to be flexible if the borrower experiences payback problems.

Philadelphia banks also participate in the Philadelphia Rehabilitation Program, which is designed to provide financing for renovation and rehabilitation rather than purchase. A small business loan program in Philadelphia has generated at least 1,000 additional jobs in the Philadelphia marketplace. The lending focus is primarily small entrepreneurial activities in neighborhoods that promote employment in these areas. Each of these programs are excellent examples of how lenders and community groups can develop an effective lending program out of common goals and concerns without the time-pressure of a pending application protest.

Success builds on itself. A group of Philadelphia banks is currently initiating a new project in North Philadelphia. This is developed and targeted, not out of confrontation, but out of mutual concerns of the private, public, and community sectors.

There is another example right here in the nation's capital. About three years ago, American Security Bank established a real estate lending department to specialize in projects which have community benefit and are profitable. (Out of 135 loans made, only 1 has been foreclosed.) The department specializes in identifying private lending opportunities which will benefit the neighborhood in some tangible way -- like bringing in jobs -- while making a profit for the bank. In the last two and one-half years, the lending programs in this department have facilitated the development or redevelopment of 5,000 dwelling units.

In Des Moines, Iowa, an agreement between a citizens group and Banks of Iowa, Inc. resulted in a commitment of $11.7 million housing loans to needy neighborhoods. One of the holding company banks, Valley National of Des Moines, lent $750,000 in the first year of the reinvestment program, waiving origination fees and points for low-income borrowers. It expects to lend $1.3 million similarly in this, the second, year of the program. Another unit of the holding company, First Bank of Davenport, met its $500,000 target in the first year, and expects to meet a similar target this year. Other units are meeting their individual goals as well.

Good ideas are contagious. Soon after the Banks of Iowa program began, Bankers Trust Company of Des Moines, an independent bank, on its own initiative agreed to invest $5 million in low and moderate income neighborhoods.

Chicago offers another striking example. A partnership between the Community Reinvestment Alliance of Chicago and three of the city's large banks resulted in the commitment of a pool of $173 million over five years for lending in low and moderate income neighborhoods.

The banks--First Chicago, Harris Bank and Trust, and Northern Trust--offer slightly below-market rates by eliminating points. But because of good credit quality and a low default rate, the banks expect to recover operating costs.

B. Unworkability of House CRA Provisions

The examples cited above are just that -- examples. There are literally thousands of programs, projects, and special lending efforts being undertaken by the member institutions of the American Bankers Association. And they are being undertaken because they strengthen the communities in which our member banks live and work.

Though our member institutions support the purposes of the Community Reinvestment Act, we must vigorously oppose the CRA provisions in Title IV of the House Banking Committee bill. The provisions would significantly alter bank responsibilities under CRA and are wholly unworkable.

Mr. Chairman, we have been asked numerous times to provide a summary explanation -- just a few pages long -- of why the House CRA provisions are unworkable. The table of contents of Appendix 1 provides a topic-by-topic summary and tells you where to look in the document for more information on each topic. I ask that all of you read Appendix 1. It is the best way I know of to get a full operational grasp of the House CRA provisions.

The CRA provisions would do five things that were not intended by Congress when it enacted the Community Reinvestment Act in 1977.

First, the provisions would link CRA obligations to bank holding company nonbanking activities.

Second, the provisions would shift the mandate of CRA from requiring affirmative efforts to meet low-income community credit needs and lending where creditworthiness permits, to requiring credit extensions specifically for low-income housing, small farms, and small businesses -- a permanent program of credit allocation.

Third, the provisions would alter CRA enforcement to rely heavily on community group protest.

Fourth, the provisions would require costly data collection efforts and result in information that does not provide an accurate picture of a bank's overall community lending activity.

And fifth, the provisions would draw heavily on the limited examiner and enforcement resources of the banking agencies at a time of important financial soundness concerns.

Let us look at each of these in turn.

1. Application to Nonbanking Activities

Under current law, CRA performance is considered when a bank merger, acquisition, or branch application is being evaluated. This application of CRA to "deposit facility" applications was determined in 1977 to be appropriate because federal and state bank charters require meeting the "convenience and needs" of the area in which the bank is chartered to operate.

There is no such "convenience and needs" assessment associated with nonbank activities under the Bank Holding Company Act. The nonbank activities of bank holding companies such as leasing, mortgage servicing, or data processing are not unique to banks. Nonbanking companies can engage in them without federal or state approval. When a bank holding company applies to engage in a nonbank activity, it is assumed that the resulting increase in competition is in itself sufficiently beneficial to meet the "convenience and needs" assessment.

Linking CRA performance to bank holding company nonbanking activities is a significant departure from the 1977 concept, and has enormous operating implications. These implications range from more bank-like treatment of bank holding companies to the potential for community group protests to occur on a weekly or even daily basis for a bank holding company such as mine.

2. "Special-Emphasis" Credit Extensions

The second way the CRA provisions diverge from CRA's original purpose relate to the potential for influencing bank lending in a very direct way.

The existing CRA statute requires depository institutions to "help meet" community credit needs. However, the House Banking Committee's amendments would require banks not only to help meet but to "meet" community credit needs. Throughout Subtitle A and B there are numerous provisions requiring that written evaluations of CRA performance, commitments, and ratings be based on a bank's record of "meeting" community credit needs. This new standard imposes a qualitatively new and different obligation on banks.

This new obligation is also reflected in the bill's requirement that "special emphasis" be placed on bank performance in meeting the credit needs of low-and moderate-income areas.

The Committee Report on Title IV says that "CRA should not be used to impose any credit allocation scheme on banking institutions." However, the bill's substantive provisions suggest -- if not mandate -- a form of credit allocation by requiring "special emphasis" to be placed on a bank's record of "serving the housing credit needs of low- and moderate- income persons, small business credit needs, and small farm credit needs." Such emphasis is required in the statement, discussion, supporting facts, and conclusions of written evaluations prepared by CRA examiners. Unless a bank maintains a favorable record of actually making such loans, it is doubtful it can earn a favorable CRA rating.

The "special emphasis" on low-income housing, small farm, and small business borrowers deemphasizes other forms of credit which may actually be of greater value to a low-income community. Examples include bank financing of community revitalization and development projects such as industrial and other job-creating projects, and educational, health, and recreational facilities.

If the House Banking Committee had held hearings on the actual structure of community credit needs, they would have found as we have from our credit assessments that there are many forms of credit that are as important or more important to a low income community than housing, farm, or small business loans. Financing for street repairs and lighting, sidewalks, sewers, day-care, community parks, pools, and playgrounds -- the list goes on and on. Not giving these credit needs equivalent priority is simply unacceptable. Needs of this sort are particularly well suited to financing with municipal revenue bonds, which banking organizations would be permitted to underwrite under Title I of H.R. 5094.

In addition to the "special emphasis" on specific kinds of credit, the House Banking Committee's CRA provisions would require ever-increasing levels of CRA performance. The provisions require the federal banking agencies to develop and publish rating guidelines for assigning a numerical rating to a bank's community reinvestment performance. The rating scale contains five levels -- Excellent, Good, Average, Limited Effort, and Poor. If a bank or bank holding company is rated in the bottom two levels, none of its agency applications can be approved. If it has a 3-rating, its applications can be delayed by community group protests for over a year. If it has a 1- or 2-rating, it is still not free of protest risk.

The new rating methodology requires "comparable resource commitments from institutions within the same size category" and specifically requires that ratings be assigned "on a comparative basis relative to the community reinvestment performances of other depository institutions with similar resources."

This methodology will result in banks being required to constantly increase their lending in the "specially emphasized" areas. If one bank increases its CRA lending to minimize the risk of application delay from community group protest, other banks with similar resources will be expected to do the same or better, even if no additional local CRA lending opportunities are available. Community groups may be able to negotiate generous CRA commitments from banks or bank holding companies needing regulatory approvals. Such commitments may create unreasonable standards for other banks to match. Failure to match such commitments, however, would result in downgraded ratings under the required comparative rating system.

The combination of the "special emphasis" lending requirement and the "comparative performance" standard causes the House Banking Committee's CRA provisions to embrace a form of credit allocation which was specifically rejected when Congress enacted CRA in 1977, and would alter fundamentally the traditional role of banks in the U.S. free enterprise system.

3. Reliance on Community Protest

The third way the House Banking Committee's CRA provisions alter the original workings of CRA relate to the balance between banks, agencies, and community groups. The original CRA legislation was structured to provide a channel through which community groups could express their concerns regarding a bank's community performance. The original CRA was intended to help establish a constructive dialogue leading to public and private cooperation. The Title IV CRA amendments disrupt this potential for cooperation by permitting community group protests to delay and disrupt bank and bank holding company operations.

Let me explain just what this means. My institution, First Union Corporation, is a $28 billion regional bank holding company. The well-being of our 20 thousand employees, about 2 million household customers, and 500 thousand business customers, in part depend on First Union being able to adjust, grow, and quickly meet competitive challenges. First Union files about 75 branch-related applications a year, about 12 applications to acquire or charter new banks, and a similar number of applications to engage in nonbanking activities like consumer leasing or mortgage servicing -- about 100 applications or notices per year or 2 per week that could be protested under the Title IV CRA provisions.

Most of these applications are now handled quickly, most within a few weeks, under expedited agency procedures. Under the proposed CRA provisions, delays running into years with enormous increases in attendant costs are quite possible. Anyone can protest an application. The CRA assessment factors are vague. The costs of protesting an application are low. The costs of filing a lawsuit to enjoin agency approval of an application are low. And if one application is protested or litigated, all subsequent applications would be affected because the same issues would be involved. My bank could be paralyzed for an extended period of time.

The protests and delay would make strategic planning impossible, would kill business enthusiasm, and in time good management would leave for better opportunities in less regulated financial industries.

How do we protect against this? Supposedly we are to work with the community groups in our market area and reach lending agreements with them that satisfy the assessment factors. But the assessment factors are vague -- when are they satisfied?

Can we rely on the agencies to adjudicate disputes? Not if CRA examinations are infrequent or can not be conducted when a dispute arises because there are relatively few examiners and long delays between examinations.

Mr. Chairman, I am afraid we will not know when the assessment factors are satisfied until the courts tell us they are. In the meantime, needed adjustments in my institution's operations will have been greatly delayed or prevented altogether. And the costs of all this will be born by our household and business customers -- including low and moderate income customers -- employees, and stockholders.

Considered on a national scale, the costs in terms of disruption and delay are difficult to comprehend. As Table 1 on the next page shows, the number of bank and bank holding company applications that could be protested under the House CRA provisions totalled 5,657 in 1986, and 5,969 in 1987. Even if only a third of such applications are protested, I find it difficult to imagine how the agencies will be able to cope with the added burden.

The implications of this for the competitiveness of the banking industry are substantial. As I noted earlier, most of the credit extended in the United States is extended by the unregulated competitors of banks, and their share is growing. The House CRA provisions will hamstring bank efforts to adjust their operations to meet competitive challenges. You must weigh these effects in your deliberations. The implications are too important to ignore.

TABLE 1

APPLICATIONS OR NOTICES BEFORE THE FDIC, FRB OR OCC* THAT WOULD BE SUBJECT TO PROPOSED CRA AMENDMENT

BANK**

12 USC 2902	NOTES	1986	1987
New OCC Charter (3)(A)	Includes bank formations, conversions from other charters.	137	89
Deposit insurance for state banks, savings banks (3)(B)	Includes new state banks (FDIC nonmember and FRB member), FDIC insured savings banks, conversions from national charters and entrance of uninsured banks.	304	244
Establishment deposit taking facility (3)(C)	Includes FDIC, FRB, OCC. Includes ATM's. Includes new branches, conversions from uninsured branches. Does not include foreign bank branches. Does not include branches converted under bank conversions above.	2,229	2,838
Relocations (3)(D)	Includes relocations of main offices and branch offices: FDIC, OCC, FRB (includes some changes in title that did not result in change in location; more detailed breakdown unavailable).	852	506
Mergers, Consolidations, Purchases, assets, etc. under 12 USC 28 (c) (3)(E)	Includes FDIC, OCC, FRB. Includes failed banks	462	724
Subtotals: Bank		3,984	4,401

**Includes FDIC insured savings banks. These number reflect completed applications. Data on applications denied is not redily available. Add 5% to total for all applications.

BANK HOLDING COMPANY ***

12 USC 1842 (BHCA Sec. 3)	Includes FRB only. Includes Board action and that delegated to Reserve Bank level. Includes BHC formations, BHC mergers, and bank acquisitions	1,131	915
USC 1843(c) (BHCA Sec. 4(c))	Includes acquisitions of nonbank companies (does not reflect expected upsurge in these applications after enactment of new powers).	542	653
Subtotals: Bank Holding Company		1,673	1,568
TOTALS		5,657	5,969

***Includes both approved and denied applications

*Sources:

(a) Statistics on Banking 1986 (FDIC, 1987) Tables 101 and 101A

(b) Information supplied by FDIC, Office of Research and Strategic Planning on 1987 banking statistics (preliminary data)

(c) 73rd Annual Report (1986) of the Board of Governors of the Federal Reserve System. "Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1986", p. 196.

(d) 74th Annual Report (1987) of the Board of Governors of the Federal Reserve System. "Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1987", p. 185.

(e) Information supplied by FRB, Division of Bank Supervision and Regulation.

4. Data Collection Burden

The House CRA provisions amend the Community Reinvestment Act to add a new section 808 requiring the development of a format for collecting data concerning bank community reinvestment activities. Such data is required to be evaluated and discussed in connection with each bank's CRA examination. Banks with assets of $100 million or more will be required to make available data relating to the following:

a. Low and moderate income housing loans.

b. Small business and small farm loans.

c. Investments and contributions in community development projects, with separate categories for low and moderate income housing and small business projects.

d. Participation in government or privately sponsored loan insurance, guarantee, or subsidy programs for housing, small businesses, or small farms.

e. Efforts to market housing and small business loans in low and moderate income neighborhoods and minority neighborhoods.

The required data may provide a misleading picture of the community reinvestment activities of many banks because the nature and scope of local credit needs in a given area are not taken into consideration. Moreover, no category is provided for community reinvestment activities other than those listed, such as charitable contributions and other non-credit-related community reinvestment efforts. Community reinvestment activities of bank holding companies and their nonbank subsidiaries are not factored in.

The Committee Report accompanying H.R. 5094 indicates that the burden of collecting such data is intended to rest with regulators and their examiners. Banks will be required, however, to develop expensive programs for maintaining such data in readily accessible form. Contrary to the Report, most banks do not currently maintain such data in their computer systems.

Moreover, in order to accurately reflect a bank's community reinvestment activities, the required data must be coded according to the use and location of the proceeds. Loan data currently maintained by banks reflects the borrower's address rather than the location where the proceeds are used. Such data may not reflect the community benefits of loans, for example, to small business proprietors who live in middle class suburban areas but use the loan proceeds to purchase equipment or inventory for a small business operation located in a low and moderate income inner city area and employing low and moderate income persons. Such loans frequently are secured by a mortgage on the borrower's residence or other personal assets and the loan data may not reflect the ultimate use or location of the proceeds.

In order to be useful in accurately measuring CRA performance, such data must be recoded in an extensive process involving review of voluminous loan files at each bank. Medium size regional banks may need to review tens of thousands of loan files, involving a tremendous expenditure of time and resources, in order to be able to provide meaningful data accurately reflecting their community reinvestment activities. Because of the weight given to such data in the CRA rating process and the importance of maintaining a favorable CRA rating in order to conduct normal activities requiring regulatory approvals, most banks will be forced to conduct extensive loan recoding efforts. Moreover, such an effort may involve reviewing loans that have been repaid in the recent past and are no longer on the bank's books since such loans are indicative of the bank's community reinvestment commitment. In other words, banks will need to maintain data on repaid as well as current loans in order to demonstrate fully their CRA performance.

5. Impact on Agency Examination Program

Regarding the impact of the House CRA provisions on federal agency safety and soundness examination programs, the testimony of the federal bank and thrift regulatory agencies is the first authority. Nevertheless, the banking industry has a view, and we are very concerned. At a time when examiner resources are in critically short supply, the CRA provisions impose additional burdens which will reduce the availability of those resources for safety and soundness purposes.

Additionally, the CRA provisions require the consumer divisions in each agency to initiate enforcement proceedings and to undertake supervisory actions to enforce compliance with consumer laws. This requirement unnecessarily duplicates the functions of the supervision and regulation divisions and gives rise to conflicts between demands of CRA compliance and financial soundness.

In this summary discussion I am not able to cite the full range of reasons the Title IV CRA provisions are unworkable and unacceptable. I ask you to read the report in Appendix 1 of my testimony. Appendix 1 contains a thorough legal analysis of the House Banking Committee's "community benefit" amendments to the Bank Holding Company Act and the Community Reinvestment Act prepared at the request of the American Bankers Association by the law firm of Arnold and Porter.

III. SUBTITLE C -- "BASIC BANKING" AND GOVERNMENT CHECK CASHING

Subtitle C of title IV requires banks, thrift institutions, and credit unions to offer basic bank accounts and government check cashing services. The stated purpose of the requirement is to assure the availability of banking services to individuals and families which do not now have a relationship with a depository institution. We are sympathetic with this concern but must oppose the proposed solution.

The "basic banking" and government check cashing requirements will increase branch operating costs, causing more branches to become unprofitable and more of them to be closed. In this circumstance, everyone loses -- low income consumers, communities, and banks.

More and more banks all the time are offering low-cost accounts as part of their effort to keep financial services available in all the communities they serve. Nationwide, 44 percent offered such accounts in 1986, and 52 percent did in 1987. The number is steadily increasing.

A closer look at the survey data reveals that a much higher percentage of large banks (those with over $500 million in assets) offer such accounts. In fact, over 70 percent of large banks voluntarily provide low cost transaction accounts. This is an important point, because these larger banks tend to serve urban populations where demand for low cost financial services is the greatest. It is also important to note that large banks hold 53 percent of the accounts and 63 percent of the dollar volume of domestic deposits. In other words, over 70 percent of the banks serving the largest number of urban customers are already providing low cost basic bank accounts.

The institutions, however, are designing accounts and offering them in a way that minimizes the costs of providing the services. Subtitle C requires that a certain kind of account and only that account will satisfy the regulation. This account may well be more costly than what many banks are now doing. The net result could be a service whose increased costs are not offset by comparable benefits -- everyone loses.

Though the House bill acknowledges the fraud loss problem and provides some remedies, they have very restrictive applicability. The problem of fraud losses remains an acute concern.

The impact on branch operating costs of the required account services cannot be ignored. A great many branches are not profitable today. Imposition of additional costs to provide basic bank accounts and cash government checks will clearly excelerate this situation. Cash availability and teller expenses, for example, will certainly go up on those days when government agency checks are delivered. If checks could be delivered on a staggered basis, this would be a big help. But even if the basic banking and check cashing services are never used, costs will be incurred. Programs will have to be set up in every bank to comply with the specific account service regulations and to offer the account continuously.

Most important, however, is it realistic to think that a small group of legislators in Washington can design a single account for use in the tens of thousands of highly individualistic markets banks serve? Is the basic bank account which works in a major city going to work on an Indian reservation or in a rural farm area? Maybe and maybe not -- but it is the "maybe" that we should be worried about. If the single nationwide account does not work everywhere, some of the groups intended to be reached will not be reached, but branch operating costs will have been increased -- everyone loses.

Because of the potential for significant adverse effects, if there is a need to stimulate greater depository institution participation in offering low-cost accounts and government check cashing services through legislation, the most that should be done is to make offering such account services one of the assessment factors under the current Community Reinvestment Act.

But there may be a better alternative.

There are a great many questions which should be answered before legally mandating the provision of specific services nationwide that could significantly impact the profitability of branches in low-income neighborhoods. To get answers to these questions, I urge this Committee to consider establishing a nationwide pilot or demonstration project involving depository institutions across the country.

A nationwide project with broad participation would enable all of us to get answers to very important questions. The questions involve key issues such as branch profitability, service types and levels, fraud-risk, paper check versus direct deposit, consumer utilization, local government/bank arrangements, etcetera. Bankers want to help assure the availability of banking services. I am confident that the American Bankers Association, the individual state associations, and our member institutions will cooperate fully with such a project.

In designing and establishing the project, I suggest involving representatives of all the parties who have direct concerns: consumer and community groups, depository institutions; federal, state, and local government check issuers; regulatory agencies; and Congress. I suggest that the project be organized and funded under the auspices of the Federal Reserve or the Treasury and that the results be analyzed by the General Accounting Office and reported to Congress and the public.

Appendix 2 of my prepared statement contains a detailed discussion of the basic banking and government check cashing provisions of Subtitle C. For a full review of the American Bankers Association's position on these provisions, I urge reading the appendix in its entirety.

IV. SUBTITLE D -- BRANCH CLOSING ANALYSIS AND NOTICE REQUIREMENT

Subtitle D of H.R. 5094 requires national banks and federal savings and loan associations to provide written notice to the appropriate regulator of their intention to close a branch. Customers of the branch must also be notified.

However, Subtitle D is much more than a customer notification requirement. If the regulators receive a complaint about the proposed closing, the institution would be required to provide to the regulator extensive, detailed statistical information on deposit activity including the number of accounts, dollar volume of deposits, and profit and loss for the three prior years, and an estimate of future deposit activity if the branch were to remain open. A similar financial analysis of loan activities would also be required by the regulator.

These required analyses are expensive and are provided only to the regulator who, from examination data, already has a great deal of information about the institution's profitability as would its deposit and loan history outlook. We urge that the analysis requirements be deleted from the subtitle.

The regulator would be required to consult with community groups to find ways to serve the community if it is determined that the branch closure would significantly decrease the availability of financial services.

The provisions of the Notice of Bank and Thrift Closure Act imply that banks are choosing to close profitable branches. This is simply not the case In fact, a recent study conducted for ABA by Booz-Allen and Hamilton shows that as many as 40 percent of the bank branches in operation today are not profitable. An estimated 50 percent of small and moderate-size branches ($20-25 million in deposits) are losing money. This study clearly indicates that rather than unnecessarily closing profitable branches, banks have tended to keep unprofitable branches open.

The declining profitability of many bank branches reflects the major changes which have occurred in the financial services industry during the 1980's. In the 1950's - 70's, bank deposit instruments were closely regulated, and financial markets were segmented. Banks and thrifts used branch systems to compete with each other for retail deposits. Today, technological advances have created integrated financial markets. Increased depositor sophistication and the deregulation of deposit interest rates have led bank customers to shift their funds out of low rate\non-interest bearing accounts into market rate accounts and into investment products banks can not offer. This shift has reduced the profitability of the industry as a whole, and of many small branches in particular.

Several other subtitles of Title IV -- especially the mandatory provision of basic bank accounts and mandatory government check cashing -- would impose significant additional costs on the branch operations of depository institutions. These costs would clearly exacerbate the already marginal profitability of many bank branches and may actually precipitate branch closings.

Congress currently has an opportunity to make a positive contribution to the profitability of branch banking by allowing banks to offer a wider array of products and services through their branches. Not only is there persuasive evidence that customers would benefit through lower costs and increased convenience, but expanding the menu of products that could be sold through branch offices would encourage more banks to maintain branch systems to serve the neighborhoods in their market area.

As the financial services industry changes, the types of financial products produced and the methods of delivery must also change. Banks, like other financial service providers, must find ways to remain profitable. Imposing a complex and expensive financial analysis procedure intended to inhibit bank branch closings will not help local communities and may in fact discourage banks from opening new branches.

For those areas which cannot support a profitable branch, a viable alternative should be found. One such alternative is the establishment of a community credit union as prescribed in the Community Development Credit Union Act.

For further discussion of Subtitle D, please refer to Appendix 3.

V. SUBTITLE E -- TRUTH IN SAVINGS

Subtitle E requires depository institutions to provide uniform disclosures of interest rates and fees on deposit accounts and establishes requirements for advertising deposit accounts.

Uniform disclosure and advertising standards for interest bearing accounts have been a goal of the Congress for several years. Much of what Congress has been proposing our member banks have been undertaking on a voluntary basis for some time. The American Bankers Association has worked closely with both the House and Senate Banking Committees on Truth in Savings legislation. Much progress has been made, and we appreciate the efforts of members of this Committee to produce workable legislation.

While we support the legislation's intent to ensure availability of simple and understandable information which enhances consumers' ability to intelligently comparison shop among accounts, we have serious concerns that it fails to achieve this goal by not encompassing mutual funds and by not requiring the National Credit Union Association Board to draft credit union regulations that are as rigorous as those for other depository institutions. Both entities are strong competitors for consumer dollars.

Arguments can be made that mutual funds and savings deposits are legally distinct products since a mutual fund investment establishes an ownership relationship while a savings account deposit results in a creditor relationship. However, from the consumer's viewpoint, mutual funds and savings accounts are functionally similar: they offer an opportunity to obtain a return on savings dollars.

It is essential that all financial institutions adopt the same standards for disclosure and advertising so that consumers may make comparisons not merely among the regulated depository institutions but among nondepository financial institutions as well. It is for this reason that mutual funds must be covered by the Truth in Savings Act.

On the issue of credit unions, while the bill states that NCUA's Board is to draft a regulation that is substantially similar, it ultimately dilutes credit union obligations by permitting the NCUA Board in drafting to take into consideration "the unique nature of credit unions...." This could jeopardize consumers in their dealings with credit unions inasmuch as they may not be fully protected under the Truth in Savings Act. Hence, this loophole should be removed and the provision be clarified to ensure credit unions are held to strict standards as well.

The provision would preclude a bank from advertising an account as free or no-cost if it imposes a minimum balance or limits the number of free transactions. While well intentioned, this proposal would have the unfortunate effect of discouraging banks from designing products to benefit market segments which have difficulty using banking services today. It should therefore be deleted.

Consumers depend on advertising as a means of comparison shopping. The provisions of this section, however, will reduce bank advertising because it imposes civil liability for advertising non-compliance. It will also confuse rather than educate consumers by imposing excessive disclosure requirements for electronic media advertisements.

We recommend amending the provision which requires that the amount of interest accruing on an interest bearing account be calculated by utilizing the full balance for computation purposes. While its objective is to require disclosure when a bank is using an investable balance method of computation, the wording of this provision may result in some misunderstanding that its purpose is to prohibit it. Hence, we suggest rewriting the provision to clarify the disclosure obligation. We believe that through full disclosure a consumer will be able to make an informed decision on whether or not to obtain such an account.

In the interest of uniformity, we also urge that a federal Truth in Savings law supersede state laws. This will enhance consumer protections by establishing comparable information being disseminated regardless of the bank involved while acknowledging the compliance problems that banks would otherwise encounter in their inter-state banking efforts if they had to comply with various state laws.

For Truth in Savings legislation to achieve the goal of ensuring that consumers will be able to make educated decisions about where to place their money, the bill must encompass mutual funds, strengthen credit union requirements and amend some other provisions of this section.

A detailed discussion of our concerns about Subtitle E is contained in Appendix 4.

VI. SUBTITLE F -- HOME EQUITY LOAN DISCLOSURE

The American Bankers Association shares Congressional concerns about protecting consumers from the loss of their most precious possessions -- their homes. Home equity financing products must be used wisely and carefully -- and we are committed to seeing that happen. As is the case with Truth in Savings, our association has been working with both the House and Senate Banking Committees to ensure that consumers are fully protected and informed when considering home equity financing.

The disclosure and advertising provisions of Section F, however, while attempting to assist consumers may inhibit the ability of creditors to continue to offer this very popular product in its current form.

As drafted, creditors will be obligated to disclose a laundry list of information and provide a separate booklet each time an individual takes an application form for a home equity loan. These would include disclosure of: annual caps on the interest rate as well as the lifetime cap; a source of information on the index; a fifteen year historical chart on how annual percentage rates (APRs) and minimum periodic payments for each repayment option would be affected by index changes used to compute the rate; disclosure of all creditor fees and estimates of third party imposed fees; and explanations of negative amortization and balloon payments, among other items.

Some items required are unnecessary and should be deleted while others would be more suitably placed in the booklet so that the consumer is not overwhelmed by initial material, yet he has the information readily availab if he needs it. Otherwise, a consumer will be confronted with pages upon pages of disclosures, and creditors will be faced with the overwhelming tas of keeping the material up to date and error free.

The advertising provisions would also expand the trigger terms -- thos terms which obligate the creditor to include explanations in the text of th advertisement. Those explanations would be increased to include such information as loan fees and opening cost estimates, periodic rates, and th lifetime annual percentage rate that can be charged.

We believe that this section should be deleted. As it is currently proposed, consumers will become confused with advertisements, particularly when excessive disclosures must be provided in the limited format of television or radio. Banks may decide to avoid such advertising because i too costly and too burdensome. As the Federal Reserve Board concluded in revising the Truth in Lending section on advertisements less than a decade ago, streamlining advertisements and reducing trigger terms enhances understandable advertising and encourages creditors to place more advertisements.

We also urge amending this legislation to provide for federal preempt of state home equity disclosure and advertising laws. This would ensure th consumers receive uniform information on home equity products and would improve compliance effectiveness of financial institutions which market th product on a regional basis.

A detailed discussion of our concerns with these and other proposed provisions is contained in Appendix 5.

VII. SUBTITLE C -- EXPEDITED FUNDS AVAILABILITY ACT AMENDMENTS

Generally, the amendments to the Expedited Funds Availability Act included in H.R. 5094 are absolutely necessary and welcome. We particular urge adoption of the amendment to allow application of all the exceptions contained in the Act to the next day availability schedule. The amendment will relieve banks from having to release large unlimited amounts of money the day after deposit before they know the funds are collectible. With on exception, we recommend adoption of the remaining amendments.

The amendment pertaining to treatment of payable through drafts conta in Section 471 of the bill greatly disturbs us. This amendment provides t a check is deemed local or nonlocal for purposes of the funds availability schedule depending on which institution issues the check, not the one to w it must be sent for payment. We oppose this amendment and very strongly encourage Congress to pass a separate amendment reversing the recent Distr Court decision which parallels the amendment contained in H.R. 5094. A revised amendment would ensure that checks and drafts are deemed local or nonlocal depending on the location of the institution to which the check o draft must be presented in order to receive payment.

Without this amendment to reverse the District Court decision, banks accepting checks classified as local under the regulation, but payable through a nonlocal institution, risk releasing funds before they know them to be available.

In addition, absent this amendment, the regulations will severely hinder the expedited processing of checks. Depository institutions will no longer be able to rely on the machine readable codes on checks, but instead will be forced to sort checks manually. Such an exercise would inevitably and significantly slow down check processing, contrary to Congress' expressed intent in the Act that the Federal Reserve Board take all imaginable steps to modernize and accelerate the check payment systems.

Further, retention of the current regulation will retard efforts to improve the check processing system by perpetuating and encouraging the practice of disbursing funds in areas remote to the issuing institutions. This system promotes delay, inefficiency, and increased costs. The bill's provision should therefore be deleted and an appropriate amendment reversing the District Court decision adopted.

Appendix 6 contains a detailed comment on the funds availability amendments.

VIII. SUBTITLE H -- EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS

These amendments are intended to eliminate perceived discrimination against women and minorities in the area of commercial lending. The proposed solution, in effect, requires depository institutions to send automatically written notices of business credit denial and extends the period banks must retain business loan applications.

The Association supports the intent of the Equal Credit Opportunity Act. However, we believe that these amendments, rather than solving the problem of perceived business credit discrimination, will antagonize and inhibit the business lending process, and, to the detriment of credit applicants, will create burdensome and costly paperwork for banks.

The ban against credit discrimination already applies clearly and completely to all kinds of credit, both consumer and business. Furthermore, the partial exemptions from the regulations for business credit are narrowly and carefully drawn and serve to recognize the realities of the business credit world. Nevertheless, under current regulations, creditors must still notify business credit applicants of adverse action and supply written reasons merely upon the applicant's request.

The purpose of the exemptions is to recognize and protect the innate distinctions in the processes of evaluating business and consumer credit. Consumer lending, for instances, in most cases, involves a single application; usual reasons for denial are easily explained and expressed in a standard form. Business credit, on the other hand, involves much more negotiation, offers and counter-offers requiring much more quantitative and qualitative analysis. The reasons for a business credit decision are tailored and particular to the specific business and applicant. Requiring automatic

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written notice will necessitate condensing complex explanations into vague, single sentence explanations.

Indeed, elimination of these exemptions may harm rather than aid busines credit applicants. Creditors could adopt standardized forms, but the notice would be far less informative or helpful than a business discussion. Effective negotiations demand the opportunity for spontaneous discussions bac and forth between parties.

Moreover, the adverse action notice itself mandated by the statute may serve as a discouragement to business applicants, particularly small business applicants. Under this bill, every counteroffer would be considered an adverse action which would require that a notice be sent to the applicant. Thus, a creditor must send written notice each time it makes a written or ora counteroffer. For example, if an applicant requests $100,000 and the bank agrees to $95,000, it would have to send a denial notice. Because business credit negotiations often involve numerous counteroffers, an applicant would be badgered by constant notices of "adverse action," a discouraging prospect for a new, hopeful business entrepreneur and an unnecessary exercise for a large, established company.

The second exemption concerning retention of records is a minor concession to the realities of the business world. Business credit applications are naturally far more voluminous than consumer credit applications. Storing them longer than the current three months could involv considerable expense.

The Association is working to help women and minority business owners. We have assisted the Federal Reserve Board in drafting pamphlets explaining Equal Credit Opportunity Act regulations and the loan process. In addition, members of various Association committees have worked with other industry groups to educate women business owners on the credit application process.

Please refer to Appendix 7 for a detailed discussion of our concerns about the proposed amendments.

APPENDIX 1

ARNOLD AND PORTER ANALYSIS OF THE
COMMUNITY BENEFIT PROVISIONS OF
TITLE IV OF H.R. 5094

This paper analyzes the community reinvestment provisions con Subtitles A and B of Title IV of H.R. 5094, as approved by the House Committee on Banking, Finance, and Urban Affairs. It is the intent paper to highlight substantive and technical provisions that make Su and B objectionable and unworkable in the view of many banking orga It is not within the scope of this paper to suggest revisions or alt that would make the community reinvestment provisions of Title IV ac to banks.

The citations referenced herein are to various sections of H. as reported in House Report 100-822 Part 1 (the "Report") and to sec the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) ("BHC the Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) ("C proposed to be amended by H.R. 5094.

* * * * *

American Bankers Association
September 8, 1988

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1. The Statement of Findings Does Not Support the Bill's Substantive Provisions

The statement of Congressional findings upon which H.R. 5094 is based does not support the bill's substantive provisions. (See § 402, Report at 26). Noticeably absent is any finding that depository institutions are not fulfilling their obligation under current law to help meet the credit needs of their local communities consistent with the safe and sound operations of depository institutions. Also absent is any finding that depository institutions are failing to reinvest funds they receive from local communities back into those communities. There is no finding that loans are not being made in reasonable proportion to deposits received in low- and moderate-income neighborhoods.

One of the key findings upon which H.R. 5094 is based is that "reduced access" to credit and deposit services for low- and moderate-income neighborhoods, small business, and small farms "threatens" to occur as a result of depository institution deregulation. There is no finding, however, that reduced access to credit and deposit services has occurred or is likely to occur or that local credit needs are going unmet.

The findings state that one of the causes of the threatened reduction in credit and deposit services is deregulation in the form of expanded powers for depository institutions. In view of the restrictions on insurance and real estate activities contained in Titles III and V of H.R. 5094, the validity of this finding may be questioned. Moreover, the comprehensive CRA review framework established by the bill applies not only with respect to new activities that may be approved in the future but to bank holding company activities currently permissible.

While the findings emphasize a threatened reduction in access to deposit services in local communities, nothing in the purposes or substantive provisions of H.R. 5094 encourages depository institutions to offer increased local deposit services. Deposit services are not mentioned as a CRA factor for which depository institutions will receive a favorable CRA evaluation.

The findings state that deregulation threatens to "detach" depository institutions from their local communities and to "reduce" access to credit and deposit services, thus emphasizing Congressional concern with discontinuation of local banking services. A key provision of the bill, however, may be interpreted to affirmatively require banking organizations to open or acquire banking offices in low- and moderate-income areas not currently served by such organizations. The so-called "patterns of activity" provision is not supported by any findings suggesting the need to force bank holding companies to acquire banks in areas not currently served by them.

The findings state that stronger "incentives" are needed to encourage depository institutions to help meet local community credit needs. Neither the statement of purposes nor the bill's operative provisions provide for any such "incentives." Rather, the bill's stated purpose is to "require" depository institutions to meet a higher community reinvestment standard and to satisfy "more rigorous criteria" in meeting community credit needs. No "incentives" are used to accomplish this purpose but rather a punitive system of procedural requirements and delays is imposed on bank holding company applicants that fail to maintain above average CRA performance. Bank holding companies with a good or excellent CRA performance likewise are subjected to procedural delays and are not provided any incentives or rewards for maintaining a favorable performance.

H.R. 5094 fails to recognize that securities firms, insurance companies, and other nonbank financial service providers are major suppliers of credit in our economy. While the bill imposes substantial community reinvestment obligations on banking organizations, no such obligation is imposed on these other credit providers to any extent whatsoever. Moreover, the bill fails to recognize the significant competitive disadvantage it imposes on banking organizations relative to these competitors as a result of the substantial procedural delays and costs created by the bill.

The bill requires an enormous reallocation of federal banking agency personnel and resources to administer the comprehensive new CRA application review and examination requirements. Separate consumer divisions must be established in each agency along with a special corps of consumer examiners and staff personnel responsible for developing and recommending new regulations to implement existing consumer laws (which may duplicate and conflict with extensive existing regulations). The bill's findings do not provide any justification or support for such an extensive and costly reorganization effort.

2. The Statement of Purposes Inaccurately Reflects the Bill's Substantive Provisions

One of the bill's key purposes is to require depository institutions and their holding companies to meet a higher community reinvestment standard when seeking approval for interstate expansion or additional powers. (§ 402(b), Report at 26). The comprehensive CRA review framework established by the bill, however, applies equally to intrastate and interstate activities. The only provision applicable to interstate expansion is a relatively minor provision prohibiting interstate acquisitions of banks th have a CRA rating of less than 3.

Similarly, the new CRA framework is not limited to expanded powers. It applies equally to currently permissible nonbanking activities. Routin bank holding company applications for bank acquisitions and other transactions also are covered by the new procedures.

Another stated purpose of H.R. 5094 is to encourage "public participation" in the regulatory process for evaluating bank CRA performan (§ 402(b), Report at 26). The bill goes far beyond this purpose, however, giving consumer and community groups unprecedented leverage to delay bank holding company transactions and to virtually dictate the terms and conditions of required CRA performance through active involvement in almos every phase of the regulatory and supervisory process and control of so-called community review boards. "Public participation" on community revie boards is limited to consumer, community, and civil rights organizations. representation is provided for other types of organizations representing, example, small business, farmers, labor, students, or local governments.

3. The Bill Establishes a Qualitatively New CRA Obligation Not Supported by the Findings or Purposes

Under current law, depository institutions are required to "help me community credit needs. (12 U.S.C. 2901 *et seq*.). Under H.R. 5094, banks will be required not only to help meet but to "meet" community credit need This new standard imposes a qualitatively new and different obligation on depository organizations that is embodied in the statement of purposes and throughout the bill in numerous provisions requiring that written evaluati of CRA performance, commitments, and ratings be based on a bank's record of "meeting" community credit needs.

The new obligation is reflected in the bill's requirement that "special emphasis" be placed on bank performance in meeting the credit needs of low- and moderate-income persons, small business, and small farms. The obligation to "meet" community credit needs also is manifested in the so-called "patterns of activity" provision which may be interpreted to require banking organizations to open or acquire banking offices in low- and moderate-income areas not currently served by them.

The nature and broad scope of the new CRA obligation is not supported by the bill's findings or purposes.

4. The "Patterns of Activity" Provision Imposes a Far-reaching New CRA Requirement

H.R. 5094 mandates denial of applications and notices by applicants that have "established a pattern" of acquiring or chartering banks "in a manner that tends to exclude" low- and moderate-income neighborhoods or equivalent areas or opening or closing deposit facilities within the bank's service area in a similar exclusionary manner. (Proposed BHCA § 11(c), Report at 28).

The term "pattern" is not defined and could be interpreted to mean as few as two instances. The phrase "in a manner that tends to exclude" similarly is not defined and does not necessarily require that the exclusion be deliberate or contemplated.

This provision imposes a far-reaching new CRA obligation on banking organizations. It suggests that banking organizations must affirmatively acquire or open banking offices in low- and moderate-income neighborhoods in order to avoid a pattern of acquiring or opening such offices "in a manner that tends to exclude" such areas. Whereas the provisions relating to branch openings and closings are limited to the bank's "service area," the provisions relating to acquiring or chartering banks are not so limited.

The Community Reinvestment Act, by its terms and the word "reinvestment" in its title, embodies a Congressional intent that banking organizations should help meet local credit needs in the communities where they are located. The "patterns of activity" provision may impose on banks an obligation to meet local credit needs in communities where they are not located. This obligation may exist even if the banking organization's financial condition cannot support such expansion and even if state branching law restricts or limits the opportunities for such expansion.

Moreover, the "patterns of activity" provision by its terms could be interpreted to apply retroactively to past bank acquisitions and branch openings and closings that occurred prior to enactment of the bill. Such a retroactive effect would penalize banking organizations for past activities that carried no sanctions at the time. If so interpreted, the "patterns of activity" provision may be constitutionally infirm in the nature of an *ex post facto* law contravening the due process clause of the United States Constitution. (*See* *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976)).

The "patterns of activity" provision discourages banks from acquiring profitable banks to the detriment of the development of strong regional and national banking organizations. It also may discourage the opening of banking facilities in low- and moderate-income areas because banks will fear that they will not be able to exit once they enter. Moreover, the provision discourages banks from selling branches to community banks that could operate them more efficiently. Banks also are discouraged from consolidating existing locations to achieve operating efficiencies.

Although patterns of closing branches may be excused if the Board determines that the closing was "occasioned by considerations relating to the safety and soundness of a depository institution," this limited relief does not address circumstances in which branch closings are dictated by lack of profitability or other factors that do not threaten safety and soundness. A bank should not be required to continue an unprofitable operation until the point when safety and soundness is threatened. Moreover, some branch closings may occur as a result of condemnation of the branch facility, expiration of a nonrenewable lease, or movement of the community away from the branch location due to demographic changes or other factors.

H.R. 5094 requires mandatory denial even if the bank presents evidence demonstrating that numerous other credit providers serve the area and that the credit needs of the community are being adequately met.

H.R. 5094 permits the Board to reconsider any application or notice that was denied on "patterns of activity" grounds during the 90-day period following disapproval. The reconsideration provision suggests that the Board may not reconsider the denied application or notice after the 90-day period, imposing a harsh result if the company later vitiates its pattern of activity.

In order to obtain favorable reconsideration, the applicant must submit a plan that the Board determines would "reasonably be expected to improve services for low-and moderate-income persons and neighborhoods." The nature and scope of the required plan is not specified and, as noted above, could be interpreted to encompass improved services over a wider geographic area than where the bank is located. The 90-day reconsideration period creates a focal point for CRA protesters to insist on CRA demands and tends to invite denials on patterns of activity grounds by the Board.

In the absence of findings justifying such a radical expansion of CRA requirements, the Board hopefully would resist an expansive interpretation of the "patterns of activity" provision. Its discretion to do so, however, may be subject to judicial review initiated by consumer and community groups.

The patterns of activity provision is unnecessary to accomplish the objectives of H.R. 5094 in view of the other significant CRA enhancements proposed, including the requirements on branch closings.

5. The Bill Embraces a Form of Credit Allocation Unsupported by the Findings or Purposes

The Explanation section of the Committee Report states that "CRA should not be used to impose any credit allocation scheme on banking institutions." (Report at 127). The bill's substantive provisions, however, suggest, if not mandate, a form of credit allocation by requiring "special emphasis" to be placed on a bank's record of "serving the housing credit needs of low- and moderate-income persons, small business credit needs, and small farm credit needs." (Proposed CRA § 809(b)(2), Report at 38). Such emphasis is required in the statement, discussion, supporting facts, and conclusions of written evaluations. Moreover, such emphasis is required without regard to safety and soundness considerations.

Unless a bank maintains a favorable record of making loans for such purposes, it is doubtful the bank can earn a favorable CRA rating under the bill. The bill thus interferes with a bank's flexibility to satisfy CRA obligations in the manner best suited to its operational structure and penalizes wholesale banks.

H.R. 5094 embraces a form of credit allocation that was specifically rejected when Congress enacted the Community Reinvestment Act of 1977.[1] The Federal Reserve Board has stated repeatedly that the CRA does not authorize it

> to dictate a bank's product mix (which credit or deposit services a bank should emphasize) or to dictate what proportion or amount of an institution's funds must, or even should, be allocated to any particular credit need, borrower or neighborhood, or on what specific terms credit should be extended.[2]

H.R. 5094 departs significantly from this view.

The element of credit allocation introduced by the bill, combined with the qualitatively new CRA obligation to "meet" low- and moderate-income credit needs, potentially will alter fundamentally the traditional concept of banks in our free enterprise system. The stated findings and purposes of the bill do not support such a dramatic new concept of banks or the community reinvestment obligations of banks.

The special emphasis on housing, small business, and farm loans detracts from other community reinvestment efforts of banking organizations which in many cases may be more effective in helping the entire low- or moderate-income neighborhood as opposed to individual borrowers. For example, bank financing of community revitalization and development projects, such as educational, health, and recreational facilities, may be equally if not more beneficial to low- and moderate-income neighborhoods as a whole. Moreover, the emphasis on loans may not directly benefit large numbers of people in low- and moderate-income neighborhoods who are renters and not homeowners.

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[1] Community Credit Needs: Hearings on S. 406 Before the Senate Committee on Banking, Housing, and Urban Affairs, 95th Cong., 1st Sess. 2 (1977) ("The Community Reinvestment Act would not allocate credit . . . .") (Opening statement of Committee Chairman Proxmire).

[2] Commerce Bancshares, Inc., 64 Fed. Res. Bull. 576, 579 (1978).

6. The Bill Confuses Money Needs with Credit Needs

The bill appears to confuse "money" needs with "credit" needs by attempting to satisfy with bank credit the needs of low- and moderate-income areas for an infusion of funds generally.

No definition or guidance is provided by the bill as to what constitutes a credit "need" that must be met by banks in order to satisfy their community reinvestment obligations. The bill does not require that such a need be demonstrated by any specific evidence or justified by normal standards of creditworthiness, collateral, or other sound lending requirements.

The bill lacks sufficient appreciation of the complexity of low- and moderate-income area funding needs and the difficulty of attempting to satisfy such needs through bank credit. For example, a prospective small business loan customer in an economically depressed area may satisfy standards of creditworthiness but be denied bank credit because the property offered as collateral does not qualify for fire insurance, without which the loan would be unsound.

Under H.R. 5094, banks may be held accountable for meeting such credit needs even though such needs cannot be met through bank loans consistent with safe and sound banking practices.

7. The Bill Affords Consumer Groups Excessive Leverage To Dictate Bank CRA Commitments

H.R. 5094 provides unprecedented leverage for consumer and community groups to extract community reinvestment commitments from banking organizations, thereby contributing to the credit allocation effect of the bill. The bill distorts the idea of community input by giving these groups the ability to virtually dictate the nature and level of required bank CRA performance through participation in almost every phase of banking supervision and regulation.

The procedures for agency processing of bank holding company applications are replete with opportunities for consumer groups to delay processing and to extract commitments for increased CRA activities by applicant banking organizations. These groups are afforded an extended 45-day public comment period on all bank and bank holding company applications and notices. A public hearing may be triggered on any application if a CRA commenter raises a "substantial issue" regarding CRA performance, even if the applicant's imputed rating is excellent and even if no evidence of unmet community credit needs is shown.

A bank holding company applicant with an average CRA rating must make commitments to improve its CRA performance in order to obtain any regulatory approvals. The commitments are publicly available and may be the subject of public comments. The applicant's efforts to fulfill the commitments is reviewed after 180 days and again in a public hearing two years later.

Similarly, a bank holding company that has established a "pattern" of failing to open banking offices in low- and moderate-income areas or of closing offices in such areas may receive regulatory approval only after making public commitments to improve CRA performance in those areas. The bill requires initial denial of applications filed by such bank holding companies, followed by a 90-day period for agency reconsideration based on commitments by the applicant to improve CRA performance. The 90-day commitment period invites demands by consumer and community groups for CRA commitments.

To avoid lengthy delays and possible denials of applications, bank holding company applicants may choose to negotiate settlements with a particular consumer or community groups to the possible detriment of other groups or neighborhoods in the applicant's local community. This process may result in preferences for specific community groups inconsistent with evenhanded treatment of borrowers throughout the community. Applicants also may be pressured to enter into commitments that the Federal Reserve Board would consider unsafe and unsound and would not otherwise impose but which an applicant might consider an acceptable price to pay for timely regulatory approval of a given transaction.

Consumer and community groups also may actively influence the required level of CRA performance by involvement in the development of the rating guidelines. In developing and annually reviewing CRA rating guidelines, the agencies are required to specifically solicit, hold hearings in each Federal Reserve district, and consider the views of consumer and community groups. No similar preference is given to the views of banking organizations or any other economic interest group.

Consumer and community groups similarly are afforded an opportunity to directly influence the assignment of CRA ratings through public notice and an opportunity to comment during CRA examinations and the making public of each bank's CRA rating.

In all phases of public participation in the regulatory process, the federal banking agencies are required to take into account the views of consumer and community groups. Consumer and community groups are given enormous influence over CRA performance and agency procedures through community review boards at each Federal Reserve Bank and separate consumer divisions required to be established in each banking agency.

No other economic interest group is accorded such preference in the bank supervision and regulation process.

8. Safety and Soundness Factors Are Deemphasized

The bill sets as a key purpose the establishment of more rigorous criteria for evaluating CRA performance, "consistent with the safe and sound operations of depository institutions." (§ 402(b), Report at 26). The operative provisions of the bill, however, are silent as to safety and soundness considerations. The obligations of depository institutions under the new CRA framework thus are not necessarily tempered by such considerations.

For example, the new CRA rating system requires comparable resource commitments from banks of similar size without specific regard to safety and soundness considerations. The bill similarly requires special emphasis to be placed on specific types of credit without necessary consideration of safety and soundness factors. In evaluating a bank's record of meeting community credit needs. CRA examiners are not required to consider safety and soundness factors.

The lack of emphasis on banking safety and soundness in the bill's substantive provisions significantly departs from the current policy of the Community Reinvestment Act of 1977 and conflicts with the bill's findings and purposes which emphasize safety and soundness.

9. Above Average CRA Performance Is Mandated for All BHCs Seeking Regulatory Approvals

The Committee Report expresses dissatisfaction with the current CRA rating system under which it claims 98 percent of banks currently have inflated ratings of 1 or 2. (Report at 129). The bill replaces the current system with a new 5-grade CRA performance rating scale:

1 -- excellent
2 -- good
3 -- average
4 -- limited effort
5 -- poor or substantial noncompliance.

(CRA § 810, Report at 39). The Report clearly contemplates that the new rating scale will result in a substantial reduction in current CRA ratings. Indeed, the scale implies that most banks will be rated 3 or "average" with some banks above average and some below average.

In denying that the new rating scale will have a bell-curve effect, the Report states that the rating system "would not rule out a high percentage of banks rising to the 1- and 2-rating levels." Id. This statement also suggests that a high percentage of banks are expected to have initial ratings of less than 2.

While the Report and the 5-grade rating scale indicate that most banks will be rated 3 or "average", such a rating is not acceptable under the bill.

Under the new CRA regulatory framework, a bank or bank holding company must achieve a "good" or "excellent" rating in order to conduct normal operations and transactions for which regulatory approval is required. The consequences of an average or below average CRA rating are severe. Only companies with a better than average rating will be entitled to regulatory approvals. (Proposed BHCA § 11(a), Report at 27). Companies with an average rating may receive "preliminary approval" through an arduous process lasting approximately one year during which commitments must be made to increase the company's rating to a 1 or 2. (Proposed BHCA § 11(b), Report at 29).

No provision is available under which a company rated below average may apply for any regulatory approvals (although the bill allows preliminary approval of an application by a below average company to acquire a bank with a rating of less than 3). (Report at 28).

Similarly, a company may not become a bank holding company unless the company commits to take actions that will increase the acquired bank's CRA rating to a 2 or better within two years. If the acquired bank has a CRA rating of 1 or 2 already, the company must commit to maintain or improve such rating. (Proposed BHCA § 11(e), Report at 29).

A bank holding company that violates commitments to have its subsidiary banks attain or maintain CRA ratings of 2 or better is subject to civil money penalties. (Proposed BHCA § 11(j), Report at 31).

Thus, the comprehensive CRA framework established by H.R. 5094 clearly contemplates, and indeed mandates, that over time all bank holding companies will have an above average CRA rating.

10. The Comparative Rating Methodology Requires Ever Increasing Levels of CRA Performance

H.R. 5094 requires the federal banking agencies to develop and publish rating guidelines for assigning a numerical rating to a bank's community reinvestment performance. (Proposed CRA § 810, Report at 38). The new rating methodology requires "comparable resource commitments from institutions within the same size category," and specifically requires that ratings be assigned "on a comparative basis relative to the community reinvestment performances of other depository institutions with similar resources."

This comparative rating system applies notwithstanding unique circumstances affecting a bank's CRA performance, such as financial condition or geographic location. Whereas the Committee Report states that "[i]nstitutions located in distressed areas, where credit needs are more extreme, shall not be held to a higher standard than institutions in more prosperous communities," (Report at 178), the operative language of H.R. 5094 provides that the former shall be held to the same level as the latter: "institutions located in distressed areas where credit needs are more extreme [are expected] to be held to equivalent levels of resource commitments as institutions in communities with stronger economies." (Proposed CRA § 810(a)(2)(B), Report at 38).

The requirement for a bank located in an economically distressed area to devote equal resources to community reinvestment as a bank of the same size in an economically healthy area is unreasonable. The opportunities for equivalent community reinvestment activities are likely to be fewer in economically distressed areas than in healthy areas. A bank located in a distressed area may not be in a financial condition capable of devoting equal resources and may be operating under supervisory restraints preventing its resources from being devoted to community reinvestment purposes. It may be anticipated that banks in distressed areas will be in a weakened financial condition generally. To impose on such banks a requirement to meet credit needs that are "more extreme" suggests that such banks are expected to lower their credit standards generally and make substandard loans that may further weaken their financial condition.

The bill's comparative rating methodology will result in constant pressure among banks to improve their CRA performance. If one bank increases its CRA lending in order to obtain regulatory approval of a pending application, other banks with similar resources will be expected to do the same or better, even if no additional local CRA lending opportunities are available. In view of the extensive participation in the supervisory and regulatory process afforded to consumer and community groups, it may be anticipated that such groups will demand ever increasing CRA performance by comparing one bank's performance to another.

Such groups may be able to negotiate extensive CRA commitments from expansion-minded bank holding companies eager for regulatory approvals. Such negotiated commitments may occur outside of the regulatory approval process and may create an unreasonable standard for other banks to match. Failure to match such commitments, however, may result in a downgraded rating under the bill's comparative rating system. Such negotiated commitments could create a total lack of uniformity in the commitment process and make comparative evaluations of banks' CRA performance impossible or inaccurate at best.

The 5-grade rating scale, with 3 being "average", encourages, if not requires, upward ratcheting of required CRA performance. If all banks are rated 2, then a bank's performance relative to other banks is only average and its rating theoretically should be downgraded to "average" or 3, thus recommencing the cycle of required commitments and improved performance to regain a rating of 2.

Ratings are assigned on the basis of the rating guidelines and are not required to take into account safety and soundness considerations. (Proposed CRA § 810(b)(1), Report at 39). Because the most CRA credit is given for loans in low- and moderate-income areas, banks will be under continual pressure to increase such lending activities in order to maintain a favorable comparative CRA rating. As a consequence, bank credit standards may be reduced and the overall quality of bank loan portfolios may deteriorate.

11. The CRA Procedures Nullify the Expedited Procedures Established in Title I

H.R. 5094 establishes complicated and lengthy application procedures for bank holding companies as an additional mechanism for reviewing the CRA performance of subsidiary banks. The new procedures are directly contrary to the purpose of the expedited notice procedures established by Title I to streamline and simplify bank holding company application procedures generally. (Section 106, Report at 14).

Moreover, the new procedures negate the considerable efforts of the Federal Reserve Board ("Board") over the years to develop expedited application review procedures that avoid unnecessary delays and minimize the regulatory costs of bank holding company operations. The Board's current procedures provide for expedited processing of the majority of applications and notices filed under the Bank Holding Company Act within 30 days of receipt of the application or notice. (12 C.F.R. 225.14(d)(1) and 225.23(a)(1)). A 15-day approval procedure is available for acquisitions of companies with assets of $15 million or less. (12 C.F.R. 225.23(f)).

The Board's procedures provide an adequate 30-day comment period on most applications beginning from the date of filing. Extensions of this period are routinely granted if requested by CRA commenters. Comments generally are received in less than 5 percent of all cases. If no comments are received, the Board is free to approve the application at the end of the comment period, which it does in the great majority of cases in which no CRA comments are filed.

The average processing period for 90 percent of the applications and notices filed under the Bank Holding Company Act was approximately 31 days in 1986 and 34 days in 1987. These include applications for bank acquisitions and _de novo_ bank formations as well as for nonbanking activities on the Regulation Y list of permissible activities.

The procedures mandated by H.R. 5094 would at a minimum double the average processing time for bank holding company applications, even in cases where no CRA comments are filed. The bill requires a 45-day comment period for all applications or notices received under the Bank Holding Company Act, beginning on the date on which the Board publishes its weekly bulletin containing notice of applications. Because publication in the weekly bulletin normally takes a week to 10 days, the close of the comment period in most cases under the bill would occur 55 days after an application is filed.

In every case, the Board must review the CRA rating of each of the applicant's subsidiary banks, even those for which it is not the primary federal regulator, and determine whether a modification of the rating is warranted in connection with the application. Before the Board may appro an application or notice under H.R. 5094, it must issue written findings regarding CRA factors which, in the case of a 1 or 2 rated applicant, are required to be issued by the 60th day after public notice of the applicat or approximately 70 days after filing.

The bill in practice likely will have the effect of establishing a minimum 70-day processing period for all applications and notices filed b and 2 rated applicants whether or not CRA comments are filed. If substan CRA comments are filed, this process extends to 90 days after public noti or approximately 100 days after filing.

In the case of applicants with an imputed CRA rating of 3, the approval process will take approximately one year, as discussed below.

By delaying proposals by all bank holding company applicants, including those with excellent or good CRA records, H.R. 5094 nullifies t intent and effect of the expedited procedures provided in Title I, create additional competitive disadvantage on banking organizations competing wi unregulated financial companies, and imposes an unworkable administrative burden on the Board.

12. The CRA Procedures Distort the Application Process and Place Disproportionate Emphasis on CRA Factors

The comprehensive procedures established by H.R. 5094 create an unnecessarily complicated framework for the processing of bank holding company applications and notices that raise no CRA issues. By using the holding company application process as the primary mechanism for enforcin increased CRA performance by banks, the bill distorts the purposes of the application process and risks a major breakdown of that process by introducing complex and unworkable procedural requirements that bear no relation to the traditional regulatory factors required to be considered under the BHC Act.

H.R. 5094 places disproportionate emphasis on bank-related CRA factors at the expense of bank holding company public benefit factors such as gains in efficiency, increased competition, and greater convenience. (12 U.S.C. 1843(c)(8)). Moreover, it does so through generally applicable procedural requirements rather than by any substantive CRA performance requirements imposed on bank holding companies and their nonbanking subsidiaries.

13. BHC Applications To Establish Qualified Securities Subsidiaries Will Be Delayed Until 1991

The bill establishes a transition rule that allows a bank holding company to rely on the most recent CRA rating of its subsidiary banks until the earlier of the next CRA examination or two years after the date of enactment. (Proposed CRA § 812, Report at 40). This rule specifically does not apply with respect to an application by a bank holding company to establish a qualified securities subsidiary ("QSS") authorized under Title I of the bill. An application for a QSS may not proceed until the applicant's subsidiary banks are rated under the new system and the applicant is assigned an imputed CRA rating, a process that likely will not occur until 1991 at the earliest.

The lack of a transition rule for QSS applications thus will make it impossible for bank holding companies to use their new securities powers until long after the effective date of Title I.

Section 411 of the bill allows a bank holding company to file a written request for a CRA examination in advance of the next regularly scheduled examination. (Section 411(c)(3), Report at 41). The appropriate agency is not required to grant such a request, however. Indeed, the agencies may not be capable of accommodating all such requests on a timely basis in view of the number of bank holding companies likely to make such requests as a precondition to filing a QSS application and the two-year deadline for CRA examinations of all 14,000 banks to be performed under the new system.

In any event, the agencies will not be able to conduct any CRA examinations and assign ratings under the new CRA rating scale until they have developed and promulgated the required CRA rating guidelines. Before such guidelines may be promulgated, the bill requires the agencies to provi public notice, solicit public comment, and conduct a separate hearing at eac Federal Reserve bank on relevant issues. (Proposed CRA § 810, Report at 38-39). Moreover, since the consumer division of each agency is responsibl for developing proposed regulations to implement all consumer laws, includi community reinvestment laws, the development of CRA rating guidelines will b delayed until such consumer divisions have been established in each agency, which is not required until January 1, 1991. (Section 411(e)(1), Report at 41).

It thus is likely that applications by bank holding companies to establish qualified securities subsidiaries will not be able to proceed unti the CRA regulatory framework is fully implemented, a process that could take several years.

Coverage of bank holding company QSS applications is not essential to achieve the objectives of H.R. 5094. The CRA performance of bank holdings companies with securities subsidiaries will be subjected to rigorous review in the bi-annual CRA examinations of subsidiary banks and in connection with subsequent applications and notices filed under the comprehensive new CRA review procedures. Indeed, every time a bank holding company with a QSS acquires an additional bank, the bill requires the company to make commitments designed to ensure that the combination of banking and securities activities will not diminish the availability of credit and deposit services.

Moreover, the bill establishes continuing enforcement procedures and imposes civil money penalties if a bank holding company fails to maintain an imputed CRA rating of at least average.

14. The Bill Imposes an Unworkable Administrative Burden on the Federal Reserve Board

The procedures mandated by H.R. 5094 leave little time for the Board and its staff to perform their required duties under the BHC Act. As noted, in every case the Board is required review the CRA rating of each of the applicant's subsidiary banks and determine whether a modification of the rating is warranted in connection with the application. (Proposed CRA § 810(b)(3), Report at 39). This requirement will be time consuming, especially with respect to banks for the Board is not the primary federal regulator of which there are approximately 13,000. If the Board assigns a CRA rating different from that assigned by the primary regulator, inter-agency negotiations may be needed.

If the applicant controls a QSS and is applying to acquire an additional bank, commitments must be constructed and approved in accordance with new section 11(d) of the BHC Act. (Report at 29).

Moreover, before the Board may approve any application or notice under H.R. 5094, it must issue written findings addressing CRA factors. (Proposed BHCA § 11(h)(3), Report at 31). In the case of holding company applicants with an imputed CRA rating of 1 or 2 on which no substantive comments are received, the Board is required to issue such written findings within 60 days after publication of notice in the weekly bulletin (or approximately 70 days after filing), leaving the Board only 15 days in which to act after the expiration of the 45-day comment period (which will occur 55 days after filing). In the case of a notice to which the expedited procedures are applicable, the Board must issue findings within 60 days after the date of filing, or within 5 days after the comment period closes.

In order to process applications and notices within these time constraints, the Board's staff will be forced to prepare written CRA findings prior to the close of the comment period. If CRA comments are filed, the Board and its staff will have insufficient time to carefully evaluate the comments and determine whether a comment raises a "substantial issue." It is unlikely that there will be time for an applicant's response to be considered before the determination is made.

If the Board determines that a CRA comment raises a "substantial issue," a hearing may be required. (Proposed BHC § 11(h)(2), Report at 31). If the applicant has a CRA rating of 1 or 2, the hearing must be completed and the required written findings issued before the end of the 90-day period after notice of the application is published, or approximately 30 days after a hearing is requested. Within this time period, the Board must provide notice of the hearing, an opportunity for the preparation of testimony and evidence by CRA protesters and the applicant, conduct the hearing, evaluate the results of the hearing, and prepare the required written findings based on the hearing.

It is doubtful that these requirements can be accomplished within the bill's required time frame, especially in view of the multitude of applications that will be pending with the Board at any given time. Moreover, the official duties of the Board members generally permit Board meetings no more often than twice a week. The Board's internal procedures require staff documents to be available to Board members at least 48 hours in advance of a Board meeting.

In view of these considerations, the procedural requirements imposed by H.R. 5094 with respect to applications by 1- and 2-rated applicants appear to be unrealistic.

The preliminary approval process required for 3-rated applicants imposes an even more overwhelming administrative burden on the Board. In addition to reviewing the ratings of the applicant and each of its subsidiary banks, determining whether the ratings should be modified, evaluating any public comments, possibly holding a public hearing, and preparing written findings on CRA factors, the Board is required to establish appropriate commitments designed to increase the applicant's rating to a 1 or 2. The commitment process could involve extensive negotiations with the applicant, CRA protesters, and the primary regulators of subsidiary banks. The Board must then review the applicant's policies and programs for implementing the commitments within 180 days after the preliminary approval. Within 30 days thereafter, the Board must make a determination as to whether the applicant's policies and programs have a substantial likelihood of resulting in fulfillment of the applicant's CRA commitments. Two years later, the Board is required to hold a public hearing concerning the applicant's performance in fulfilling the commitments.

This extensive process is required for every single application or notice, of which there will be many, filed by a 3-rated applicant until the applicant attains a rating of 2 or better. Since H.R. 5094 contemplates that most bank holding companies will start out with an imputed rating of 3, the burden of the preliminary approval process is considerable and will require a significant increase in Board and Reserve Bank staff devoted to the application process.

Other provisions of the bill impose extensive additional CRA-related tasks on the Board, such as required rulemaking and annual review of CRA performance guidelines, the requirement for bi-annual CRA examinations, and the establishment of a separate CRA examiner corps.

(5) The Bill Imposes Significant Regulatory Costs and Places BHCs at a Competitive Disadvantage Relative to Other Credit Providers

The elaborate and lengthy CRA application procedures can be expected to increase significantly transactions costs to bank holding company operations and to result in missed competitive opportunities. Bank holding company transactions frequently are structured and priced according to the estimated time required for regulatory approval. Bank holding companies already suffer a considerable competitive disadvantage when bidding for acquisition opportunities against nonregulated competitors not burdened by regulatory delays in their ability to consummate a deal. H.R. 5094 will exacerbate this competitive disadvantage.

16. Routine Bank Holding Company Transactions Are Unnecessarily Subjected to Complex CRA Procedures and Requirements

H.R. 5094 extends the Community Reinvestment Act far beyond its current scope to apply to bank holding companies and their nonbanking affiliates. Bank holding companies are assigned an "imputed" CRA rating and all bank holding company applications and notices for nonbanking activities and other transactions are subjected to the rigorous CRA procedures and performance requirements described above. Similar requirements are applicable to thrift institution holding companies.

Under the current Community Reinvestment Act, CRA review is conducted during bank examinations and regulatory approvals directly involving the acquisition or activities of a federally insured bank. The current scope of the CRA is appropriately limited to transactions directly involving banks in view of the theoretical basis of the Act to encourage the reinvestment of federally insured deposits in local communities in the form of credit.

H.R. 5094 extends the CRA review process to all bank holding company activities and transactions for which regulatory approval is required, regardless of whether such activities or transactions are bank- or credit-related or involve expanded powers. For example, the comprehensive CRA review procedures are triggered by bank holding company applications to engage in currently permissible activities such as data processing, trust activities, real estate appraisal, underwriting U.S. government securities, and tax planning and tax preparation which have no relation to the granting of credit. Routine bank holding company requests, such as a request for approval to extend the time for disposing of shares acquired in satisfaction of a debt previously contracted (12 U.S.C. 1843(c)(2)), similarly may involve extensive CRA review procedures. (Because an application is required for such a request under the BHC Act, the CRA review procedures may apply even though current Federal Reserve procedures do not require an application. 12 C.F.R. 225.22(c)(1)).

The bill provides an exemption for safe deposit, personnel, accounting, and other servicing activities listed in 12 C.F.R. 225.22(a) and (b). (Proposed BHCA § 11(a)(3)(A), Report at 27). These activities are related to internal holding company operations for which no prior regulatory approval is required under the Bank Holding Company Act. 12 U.S.C. 1843(c)(1)(C). The intended exemption thus has no exemptatory effect.

By specifically exempting these activities, however, the bill creates doubt as to whether the new CRA review procedures are intended to be applicable to other nonbanking activities and transactions described in 12 C.F.R. 225.22 for which no exemption is provided. The other subsections relate, for example, to voting securities acquired in a fiduciary capacity (12 C.F.R. 225.22(c)(3)), securities or property representing 5 percent or less of a company (12 C.F.R. 225.22(c)(5)), and assets acquired in the ordinary course of business (12 C.F.R. 225.22(c)(7)). Like the servicing activities in 12 C.F.R. 225.22(a) and (b), no application is required for these activities under the BHC Act.

In view of the significant other CRA enhancements in the bill, as well as opportunities for CRA review of banks under current law, the extension of elaborate new CRA procedures and requirements to routine bank holding company transactions is unnecessary to ensure CRA compliance. Such transactions often have no connection to credit-related activities and thus no CRA relevance. The coverage of such transactions will significantly increase regulatory costs for bank holding companies and the administrative burden on the Federal Reserve Board with minimal gain in CRA compliance.

17. Companies that Control Nonbank Banks Are Not Subject to Similar CRA Requirements

Companies that control banks but which are not bank holding companies as a result of grandfather rights conferred by the Competitive Equality Banking Act of 1987 will not be subject to the extensive CRA procedures and requirements established by H.R. 5094. The new CRA framework will be lodged in proposed new section 11 of the Bank Holding Company Act and will not be applicable to companies that do not qualify as bank holding companies under the Act.

Thus, companies controlling so-called "nonbank banks" will be able to continue to conduct normal business activities unencumbered by the burdensome new CRA compliance requirements applicable to bank holding companies. (Securities and other companies that become bank holding companies by acquiring a bank in the future will be subject to the new CRA framework under proposed BHCA § 11(e)). The nonbank banks owned by such companies will be subject to the new CRA rating scale and performance guidelines like other banks, but will not operate under commitments designed to enforce above average CRA performance.

18. The Bill Creates a Competitive Disadvantage for Banks Owned by Holding Companies Versus Independent Banks

Banks owned by bank holding companies will be at a competitive disadvantage relative to independent banks since the new CRA commitment requirements are applicable only in the context of the bank holding company application process. Independent banks will not be forced to operate under commitments designed to increase their CRA ratings to above average over a two year period as will banks owned by holding companies.

19. The Bill Inappropriately Imposes Burdensome CRA Procedures on Foreign Banks Not Subject to CRA

The comprehensive CRA procedures established in proposed new section 11 of the BHC Act will be applicable to applications filed by foreign banks to engage in certain nonbanking activities pursuant to sections 4(c)(8), 4(c)(9), and 4(c)(13) of the BHC Act even though such foreign banks may not operate any banks in the United States.

Foreign banks are required by the International Banking Act of 1978 to obtain approval under the BHC Act to engage in nonbanking activities in the United States if they operate a domestic branch or agency. Such banks are not regulated as bank holding companies and their non-FDIC-insured branches and agencies are not subject to the Community Reinvestment Act. Extension of the burdensome procedural requirements established by H.R. 5094 to applications filed by such foreign banks under the BHC Act thus is unnecessary and inappropriate.

20. The Imputed CRA Ratings Inaccurately Reflect CRA Performance

The imputed rating system established by the bill inaccurately reflects the overall CRA performance of a bank holding company by basing the holding company's imputed CRA rating on the least favorable CRA rating of a bank holding company's subsidiary banks. (Proposed BHCA § 11(f), Report at 29). If all of the company's subsidiary banks are rated "1" except for one bank that happens to be rated "5", the company's imputed CRA rating will be a

"5". The imputed "5" rating will apply notwithstanding that the 5-rated subsidiary bank represents a small fraction of the holding company's total deposits or assets. As noted above, such a company generally will be precluded from obtaining any regulatory approvals under the BHC Act for normal operations and activities.

A special rule applies in the case of a bank holding company with five or more bank subsidiaries in a single state. The parent company's imputed rating is one above the lowest bank rating provided that 80 percent of the company's bank subsidiaries are rated above that rating. A bank holding company with five or more bank subsidiaries in more than one state similarly is assigned an imputed rating of one above the lowest rated bank subsidiary if not more than 7.5 percent of all of the company's bank subsidiaries have the rating of the lowest rated bank. Thus, in the example above, the holding company's rating would be a "4" rather than a "5", notwithstanding that all of its other banks are rated "1".

The special rule provides more favorable treatment for banking organizations located States that traditionally have allowed multi-bank holding companies than in states that only recently have abandoned unit banking structures or are phasing-in multi-bank holding companies.

In either case a bank holding company with an otherwise satisfactory CRA record will be penalized for an unsatisfactory CRA rating of a subsidiary bank, even though that bank's poor CRA record may be due to factors making a more favorable rating impossible. For example, a bank located in an economically distressed area may not have the resources to meet local credit needs. Moreover, a bank in a weakened financial condition due to regional economic circumstances may be discouraged by its primary state or federal banking supervisor from devoting its limited resources to low- and moderate income credit needs in its local community.

H.R. 5094 assumes that all bank subsidiaries are wholly-owned by the parent companies. Under the BHC Act, however, a bank may be deemed to be a subsidiary of more than one bank holding company. Under H.R. 5094, the CRA performance of a bank may be imputed to a bank holding company even though the company controls as little as 25 percent of the bank's shares and has n control over the community reinvestment policies or activities of the bank.

2). The Exemptions from the Imputed Ratings Are Inadequate

H.R. 5094 excludes certain banks from a holding company's imputed rating, such as certain troubled, newly chartered, agricultural, and very small banks. (Proposed BHCA § 11(f)(4), Report at 30). The exceptions fai to take into consideration other circumstances which may cause a bank to ha a poor CRA rating, such as state laws that restrict the ability of certain banks to make local housing or small business loans. For example, some mor center bank holding companies operate banks in Delaware that engage primari in credit card operations but which are not excluded from imputed ratings under the bill because they are not covered by the so-called "nonbank bank" exemption under the Bank Holding Company Act. These banks are prohibited b Delaware law from serving local community credit needs and thus do not have the ability to earn an above average CRA rating. The parent holding companies of these banks with otherwise above average CRA ratings thus will be unfairly penalized.

Banks acquired on an emergency basis and banks acquired with a CAMEL rating of 4 or less are exempted, but only during the two year period following their acquisition and only if the parent company submits a plan within 90 days from the date of acquisition to increase the bank's CRA rating to a 1 or 2. In many cases, more than two years is required to restore such a bank to a healthy condition with the ability to earn a favorable CRA record, especially banks whose financial conditions are adversely affected by regional economic distress. Moreover, the exemption is not available for such banks acquired before December 31, 1985, of which a number exist that continue to be troubled.

No exemption is provided for healthy banks that subsequently become troubled or for banks located in areas of economic distress. Although an amendment to provide such an exemption was offered during the Committee mark-up of H.R. 5094, and many observers understood that it was agreed to, the reported version of H.R. 5094 fails to include the amendment.

The exemption for banks acquired with a CAMEL rating of 4 or less creates a substantial likelihood that the bank's CAMEL rating will be disclosed to the public since section 809 of H.R. 5094 requires that CRA numerical ratings and the basis for such ratings be made publicly available. The exclusion and basis for exclusion of a troubled bank from the parent's imputed rating thus will become known. Disclosure of a bank's low CAMEL rating could have a serious adverse effect on the safety and soundness of the bank and its parent holding company, as well as raise a conflict with the current supervisory policy of not disclosing CAMEL ratings.

In one area the exemptions to the imputed ratings appear to be more generous than may have been intended. H.R. 5094 exempts agricultural banks with assets of $50 million or less. An "agricultural bank" is defined as "any bank which has 25 percent or more of its loan assets in agricultural loans or real estate loans" made to customers in the bank's local market area. A "real estate loan" is not defined and could mean any loan secured by real estate, including home mortgages and other housing loans whether or not located in a rural area. Thus, the agricultural bank exemption may apply to urban banks as well as banks located in farm areas.

22. No Safe Harbor Incentive Is Provided for 1 and 2 Rated Bank Holding Companies

Although the Committee Report indicates that the bill is intended to provide a safe harbor for 1 and 2 rated bank holding companies (Report at 125), no such safe harbor is included in the bill's operative provisions. Bank holding companies with "good" and "excellent" imputed CRA ratings are subjected to burdensome CRA review procedures under H.R. 5094 notwithstanding favorable CRA performance. As noted above, the procedures mandated by H.R. 5094 would approximately double the average processing time for applications filed by such bank holding companies, even in cases where no CRA protest is filed.

Moreover, 1 and 2 rated companies will face the possibility of having their CRA ratings modified in connection with the application process. The Board is required to review the CRA rating of the applicant and each bank subsidiary in connection with each application or notice and may modify such ratings for purposes of acting on the application. (Proposed CRA § 810(b)(3), Report at 39). Companies with favorable CRA ratings are required to make CRA commitments each time they acquire an additional bank if they control a qualified securities subsidiary.

The bill thus subjects 1 and 2 rated bank holding companies to significant procedural delays and uncertainty. The public CRA examination

process provides ample opportunity for review of the company's CRA rating and affords public input into the evaluation of the CRA performance of its subsidiary banks. CRA examinations are required to be conducted every 24 months. Any reduction in CRA performance thus can be criticized and corrected within a reasonable period of time.

23. The Preliminary Approval Procedure for 3-Rated BHCs Imposes Excessive Delay and Uncertainty

H.R. 5094 provides a lengthy and arduous CRA review procedure for bank holding company applicants with a 3 or "average" imputed CRA rating under which final approval cannot occur until approximately one year after the application is filed. Since the bill appears to contemplate that most bank holding companies will have an initial rating of 3 under the new system, the preliminary review procedures will affect a significant number of bank holding companies.

Companies with an average rating are not entitled to normal regulatory approvals but may receive "preliminary approval" provided the company makes commitments to earn an imputed rating of 1 or 2 within two years. (Proposed BHCA § 11(b), Report at 27). The commitments required are not specified, but in imposing such commitments the Board is required to take into account any public comments or hearing testimony. Given the likely differences of opinion in public comments on applications originating from different geographic areas, the nature of the commitments required of 3-rated applicants may be expected to vary greatly from case to case, causing uncertainty as to the requirements necessary to obtain regulatory approval.

No time limit is established within which a Board order granting a preliminary approval is required under the bill. Assuming that a public hearing is likely to be held, and leaving time for the Board to determine the nature and scope of commitments required, a preliminary approval should not be expected earlier than 120 days. The preliminary approval is then subjected to a 180-day review period and does not become final until 210 days after issuance.

It is not clear whether a bank holding company could legally consummate a transaction on the basis of a preliminary approval. At the end of the 180-day period following a preliminary approval, the Board is required to review the policies and programs adopted by the applicant to implement the required commitments. Unless the Board determines that such policies and programs have a substantial likelihood of fulfilling the commitments and issues a final approval order within 30 days thereafter, the preliminary approval ceases to be effective.

The 30-day period for final approval of a preliminary approval assumes critical importance because the failure of the Board to grant a final order automatically cancels the preliminary approval without opportunity to reinstate it without filing another application. A bank holding company could face the loss of a preliminary approval simply due to agency staff error or other unexpected circumstances that would result in the lapse of the 30-day deadline without the issuance of a final order.

Thus, a 3-rated applicant will not have final regulatory approval until approximately one year after an application is filed. Consummation of an acquisition transaction prior to final regulatory approval would be highly risky. If a final order is denied or the 30-day period lapses without a final order being issued, the transaction would have to be unscrambled.

H.R. 5094 specifically provides that a preliminary approval shall be treated as a final order for purposes of commencing the 30-day period for Justice Department review and commencement of judicial review proceedings under the BHC Act. It is unclear under the bill, however, whether a second 30-day review period commences following the issuance of the Board's order finalizing the preliminary approval. The possibility of two separate judicial review periods could compound the complexity of any litigation likely to result from the complicated new CRA procedures and requirements.

Bank holding companies with an average CRA rating must factor such uncertainty into all transactions requiring approval under the Bank Holding Company Act. Many such companies may find it impossible to conduct normal transactions under such conditions.

H.R. 5094 requires a hearing to be held two years after a preliminary approval at which consumer and community groups must be given an opportunity to testify concerning the applicant's fulfillment of commitments upon which the preliminary approval was based. H.R. 5094 does not require that the applicant or other interested persons be accorded the same opportunity to testify. No specified consequences attach to the hearing, although presumably the hearing testimony will be taken into consideration in determining whether the applicant has earned the required imputed rating of 1 or 2. The extensive participation of consumer and community groups and the lack of similarly required participation by banking organizations may place the Board in the position of having to defend the applicant's CRA record. The hearing requirement is unnecessary in view of ongoing monitoring of compliance with commitments in the supervision and examination process.

24. Repeated Commitments Are Unnecessary And May Cause Uncertainty as to Required CRA Performance

Until a 3-rated applicant achieves an above average imputed rating, every application or notice filed by the applicant is subjected to the preliminary approval procedure. The requirement for repeated commitments and delay seems redundant and punitive since the first application will satisfy the bill's objective to force bank holding companies to increase their imputed ratings to 1 or 2 over a two-year period. The commitments required in the first application should be sufficient to achieve the required above average rating without the necessity of requiring the same or similar commitments over and over again.

The extensive applicant commitment requirements throughout the bill are redundant and could result in differing or inconsistent commitments from one application to the next. Confusion and uncertainty thus may occur as to the level of performance required by a given holding company to attain the required above average rating.

Because the commitments are specific to each applicant and are influenced by public commenters representing diverse interests with varying demands, different levels of CRA performance may apply to different banks, notwithstanding the bill's requirement for comparable CRA performance. Negotiated commitments occurring outside the regulatory approval process will compound the uncertainty as to the required level of CRA performance and compromise the integrity of the commitment process as an appropriate method for achieving improved CRA performance.

The required procedures do not provide that the Board may modify or provide relief from the applicant's commitments if, upon review, it is determined that such modification or relief is warranted. Applicants thus may be bound by commitments that are no longer appropriate or necessary.

The requirements for repeated commitments may cause bank holding companies to delay or artificially structure community reinvestment activities in order to allocate such activities to anticipated commitment requirements in future applications.

25. The Requirement for Public Commitments Will Inhibit the Commitment Process and May Cause Safety and Soundness Problems

Proposed new section 11(i) requires that all commitments "proposed or agreed to" by an applicant pursuant to the preliminary approval procedures be made available to the public. (Report at 31). There is no requirement that commitments made pursuant to other provisions of Title IV of H.R. 5094 be made publicly available.

The requirement for public disclosure of an applicant's proposed commitments will unnecessarily complicate and inhibit the process by which commitments are agreed to. Applicants will be reluctant to propose commitments that later may be held against them and the commitment process thus will be less effective in developing workable solutions to community reinvestment problems.

Moreover, public disclosure of commitments involving banks with supervisory problems may not be possible without disclosing that such problems exist, to the detriment of safe and sound banking operations.

26. The Requirement for CRA Commitments and Review Under the BHC Act Interferes with Supervision by a Bank's Primary Regulator

The extensive CRA commitment requirements under proposed new section 11 of the BHC Act may interfere with bank supervision and regulation by a bank's primary regulator, state or federal. The required commitments are directly applicable to subsidiary banks and may subject such banks to requirements objectionable to the bank's primary regulator. The commitments may be inconsistent with the primary regulator's supervisory program for such a bank and may undermine the regulator's enforcement and compliance efforts with respect to such bank. For example, commitments may be imposed under the BHC Act for increased loans with below-market interest rates or for reduced collateral requirements that the primary regulator may find unsafe and unsound with respect to a specific bank. Similarly, a commitment for increased small business or farm loans may be inconsistent with the primary regulator's efforts to encourage a more diversified asset portfolio.

The primary regulator may disagree with the Federal Reserve Board as to the specific performance required for a 1 or 2 CRA rating. Under the bill, the Board is required to review the CRA rating of "any insured depository institution involved with respect to such application" and may modify such rating for the purpose of acting on the application. (Proposed CRA § 810(b)(3), Report at 39). All of an applicant's subsidiary banks may be deemed to be involved with respect to an application since the Board generally reviews the financial and managerial resources and future prospects of each bank in the holding company system in connection with applications filed under the BHC Act. The Board may assign to a subsidiary bank a CRA rating different from that assigned by the bank's primary regulator, resulting in inter-agency conflict and uncertainty to a bank attempting to comply with specific commitment requirements.

In view of H.R. 5094's objective to improve the CRA performance of banks, the bill's use of the bank holding company application process to accomplish this goal indirectly rather than directly through the bank regulation process seems inappropriate and likely to unnecessarily complicate bank supervision and regulation.

27. The Bill's Complex CRA Procedures and Requirements Invite Potentially Disruptive Litigation

The bill's complex CRA procedures and requirements invite litigation with potentially major disruptive consequences for the regulatory approval process and individual bank holding company applicants. The bill creates increased opportunities and incentives for consumer and community groups and banks to commence litigation challenging the adequacy of the CRA rating guidelines, assignment of ratings to individual banks, adequacy of CRA commitments, Federal Reserve approvals and preliminary approvals, denial of hearing requests, and other CRA matters.

For example, a community group could significantly frustrate a bank holding company's ability to conduct operations requiring regulatory approval by contesting the company's imputed CRA rating and seeking a temporary restraining order to enjoin the Board from granting any regulatory approvals to such company on the basis of the rating. The company's ability to enter into any transactions requiring regulatory approval would be virtually paralyzed as long as such an action were pending since an adverse judicial decision could require unscrambling of transactions or disengaging from activities with loss of customer good will.

The comparative rating system will encourage lawsuits because of the difficulties and possibilities for factual error in measuring one bank's CRA performance versus that of others. Such litigation may place the courts in the position of assigning CRA ratings in a large number of cases, a role for which the courts are not suited.

Community groups could challenge a Board interpretation of the patterns of activity provision as requiring, for example, at least ten branch closings in order for a pattern to exist. If successful, such a challenge could result in the invalidation of numerous Board orders approving bank holding company transactions based on such an interpretation. The mere pendency of such a lawsuit may discourage the Board from approving applications or applicants from negotiating or consummating transactions.

Consumer groups could seek and be granted a judicial stay of any Board actions pending a final court ruling on such major issues as the patterns of activity provision or the validity of the rating guidelines. Such a stay could virtually freeze the entire application process.

Banks similarly will have increased opportunities to challenge adverse agency interpretations or decisions. For example, a group of banks might commence a judicial action arguing that privately negotiated commitments undermine the integrity of the comparative rating system, impose an unfair burden on banks unwilling to negotiate, and may not lawfully be used as a basis for regulatory approvals or CRA ratings. If successful, such an action could call into question the validity of numerous Board orders approving bank holding company transactions based on privately negotiated commitments as well as the validity of CRA ratings based on such commitments.

By using the BHC Act as the primary vehicle for enforcing increased bank CRA performance, H.R. 5094 exposes the application process and bank holding company operations to potential major disruption by litigants seeking judicial adjudication of a host of issues raised by the complex and far-reaching new CRA framework.

28. Below Average Rated Applicants May Not Improve Their CRA Ratings by Acquiring Above Average Banks

H.R. 5094 generally precludes bank holding companies with imputed ratings of 4 or 5 from obtaining any regulatory approvals. Thus, if such companies are to attain an above average imputed CRA rating, they must do so generally by internal improvements. H.R. 5094 creates an exception to this general rule that allows below average rated companies to acquire banks with CRA ratings of less than 3 pursuant to the preliminary approval process. (Proposed BHCA § 11(b)(7) Report at 28).

A below average rated applicant may not acquire an above average rated bank and thereby improve its imputed CRA performance. This result seems at odds with the intent of the bill to improve CRA performance of depository institutions generally. An above average bank could provide guidance and assistance to the parent company's other bank subsidiaries that would enable them to improve their CRA performance.

29. The Additional Commitments Relating To Securities Activities Are Excessive and Apply to BHCs Not Engaged in Securities Activities

H.R. 5094 imposes additional requirements on bank holding companies with respect to securities activities. Under proposed new section 11(d), a bank holding company applying to establish a qualified securities subsidiary ("QSS") (as defined in Title I of the bill) is required make such commitments as the Board may require to provide

> reasonable assurance that the proposed combination of banking and securities activities (if any) within the bank holding company structure following the approval of such application will not diminish the availability of credit and deposit services for low- and moderate-income persons or small businesses or within low- and moderate-income neighborhoods or equivalent areas.

(Report at 29).

The intent and effect of this provision are unclear. Section 11(d) appears to be based upon some perceived connection between securities activities and credit and deposit services, but the nature of that connection is not readily apparent. The intent of this section may be to prevent banks that currently serve the retail banking public from becoming wholesale banks.

The term "diminish" is not defined by the bill but suggests that any reduction in services will not be allowed. Thus, section 11(d) reduces bank flexibility to structure activities according to competitive and marketplace demands.

Section 11(d) appears to assume that a bank holding company with a QSS will offer a "combination of banking and securities activities." Titles I and II of H.R. 5094, however, go to great length to prohibit a QSS and affiliated banks from engaging in combined activities. Thus, section 11(d) arguably will not be applicable in any case because combined banking and QSS securities activities are not allowed. Section 11(d) does not define "securities activities", however, and could refer to the offering of securities brokerage services or investment advice by a bank affiliate of a QSS.

Section 11(d) is worded in such a way that a bank holding company would not be precluded from diminishing its credit and deposit services as long as such services are readily available from other sources. The provision could be interpreted, however, to mean that each applicant may not diminish the availability of such services offered by it particularly rather than by all banks generally. The provision thus could have the effect of locking banks into maintaining their current level of services to low- and moderate-income areas regardless of legitimate factors that may justify diminished services in a particular area. Moreover, it could be interpreted to require the opening of new credit and deposit facilities in low- and moderate-income areas.

The Board is required to take into account any public comments or testimony from CRA commenters in determining what commitments will satisfy the requirements of section 11(d) in any given case. The commitments may vary from applicant to applicant depending on the various demands of CRA commenters, resulting in bank holding companies being subjected to differing levels of required CRA performance.

Section 11(d) requires new commitments to be made each time a bank holding company with a QSS applies to acquire an additional bank. This requirement for repeated commitments seems excessive and can only compound the uncertainty as to the required level of CRA performance and create potentially greater variations in the level of performance required from one bank holding company to the next.

The requirement for additional commitments at the time of each bank acquisition also suggests that section 11(d) is intended to operate as a "patterns of activity" provision that could be used to prevent bank holding companies from closing banking facilities in low- and moderate-income areas or to force them to acquire banks in such areas.

Section 11(d) strangely requires commitments relating to the combination of banking and securities activities even if the applicant engages in no securities activities. Section 11(d) applies to any application to acquire control of a bank by "any company which, at the time of application, is not a bank or bank holding company." The provision thus applies to bank holding company formations by companies organized by individuals for the sole purpose of acquiring a bank.[3] Such individuals may have no intention of establishing a QSS or otherwise engaging in securities activities through the company, yet are subject to the requirement for commitments relating to securities activities.

Section 11(d) also applies to the acquisition of a bank by a company engaged in nonbanking activities permissible under the BHC Act, such as a leasing company or data processing company. Such a company similarly may have no intention of engaging in securities activities, yet is subject to section 11(d).

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[3] Although a special notice procedure is provided in Title I of the bill for shell one bank holding company formations, this procedure is available only in certain limited circumstances. (Report at 13).

Section 11(d) appears to recognize that not all applications to which it applies may involve securities activities. The language refers to "the proposed combination of banking and securities activities (if any)". If no securities activities are involved, it is unclear whether the entire provision is inapplicable. The provision could be interpreted to apply to the "proposed combination of banking . . . activities . . . ."

30. New Bank Holding Companies Must Make Higher Commitments than Existing BHCs

H.R. 5094 requires additional commitments from companies that are not bank holding companies at the time such a company applies to acquire a bank. By its terms, the bill applies to all such companies, including shell bank holding companies. Under proposed new section 11(e), such a company must commit to take such actions that will enable the bank to achieve a CRA rating of 2 or better within two years or, if the bank already has a rating of 1 or 2, to "maintain or improve" such rating. (Report at 29).

The Board must take into account any CRA comments or testimony in requiring commitments, thereby creating further potential for widely varying commitments and uncertainty as to the required level of CRA performance.

This requirement discourages the acquisition of banks with below average CRA ratings by companies that would be capable of improving the bank's CRA performance. Moreover, the requirement for commitments that will "maintain or improve" the rating of a 1 or 2 rated bank imposes a burden on new bank holding companies that is not imposed on existing bank holding companies. The requirement for a new bank holding company to commit to improve the rating of a newly acquired bank with a CRA rating of 1 seems excessive and contributes to the upward ratcheting of required CRA performance inherent in H.R. 5094.

31. The 45-day Comment Period Is Excessive, Does Not Require Written Comments, and Is Not Limited To CRA Comments

As noted above, the bill's 45-day public comment period for bank holding company applications and notices will result in a doubling of the minimum time required for regulatory approvals under current procedures. (BHCA § 11(h), Report at 31). The public comment period begins on the later of the date of publication of notice of the application in the Federal Reserve Board's weekly bulletin or the date of newspaper publication. Allowing for a 7-10 day delay from the time an application is submitted to the date of its publication in the weekly bulletin, the bill establishes nearly a 55-day period during which the Board is precluded from acting on an application, even when no CRA comments are filed. Under current procedures the Board may, and in the great majority of cases does, act after 30 days.

Moreover, by consuming most of the 60-day processing schedule, the 45-day (55-day in reality) public comment period will leave little or no time for an applicant to respond to a CRA protest or for careful evaluation by Federal Reserve staff. Comments typically are not filed until the end of the comment period.

H.R. 5094 is not based on any Congressional findings indicating that the 30-day comment period provided under the Board's current procedures affords insufficient opportunity for CRA commenters to present their views on bank holding company applications and notices. In cases where a 30 day period is inadequate, the Board routinely extends the comment period upon request.

Section 11(h) negates the intent of the expedited procedures established by section 106 of Title I of H.R. 5094 by requiring the Board to accept public comments on any aspect of a proposed transaction for which regulatory approval is requested. Section 11(h) does not limit public comment to CRA factors. Thus, competitors will have the ability to slow down bank holding company transactions by filing comments raising irrelevant non-CRA-related issues that in the majority of cases are ultimately found to be nonsubstantive, contrary to the intent of the expedited procedures.

Although the caption for section 11(h) indicates that comments are intended to be submitted in writing, the operative language of section 11(h) does not require written comments. If verbal comments are allowed, bank holding company applicants will have difficulty responding to such comments.

32. The Hearing Requirement Does Not Require the Presentation of Specific Evidence Showing Unmet Credit Needs

Proposed new section 11(h)(1) provides that an informal hearing may be held at the request of any commenter who, in the Board's judgment, raises a "substantial issue" regarding the applicant's performance in serving local community credit needs or the adequacy of the applicant's required CRA commitments. (Report at 31). What constitutes a "substantial issue" triggering a hearing is not defined.

No time limit on the length of the hearing or the scope of matters to be addressed at the hearing is established by the bill. Commenters requesting a hearing are not required by the bill to present any facts or evidence demonstrating that the applicant is not fulfilling its CRA obligations or that community credit needs are going unmet. Unless commenters are required to present concrete evidence of unfulfilled credit needs to which an applicant can respond, the hearing will not serve a useful purpose other than to unnecessarily delay approval of the applicant's application or notice.

33. The Requirement for Written Findings In Cases in Which No Substantive CRA Comments Are Filed Is Unnecessary

Proposed new section 11(h)(3) requires the Board to prepare and make public a written finding "with respect to each factor the Board is required to take into account" under section 11 before approving any application or allowing expiration of the period for disapproval of any notice.

Section 11 does not identify any "factors" that the Board is specifically required to take into account in acting on applications and notices, thus raising a question as to precisely what the Board's written findings are required to address. Presumably, the Board is expected to address any issues raised by public commenters. The Board also might be expected to address the adequacy of the applicant's CRA commitments and the results of the Board's review of each applicant's CRA rating (as required by proposed new section 810 of the Community Reinvestment Act).

The bill could be interpreted to require the Board to prepare written findings on non-CRA-related issues raised by public commenters, contrary to the intent of the expedited procedures in Title I.

The requirement for written findings applies even if no CRA comments are filed or no comment raising a substantial CRA issue is filed. The requirement for the Board to address the applicant's CRA performance by written findings in such cases seems excessive, especially since the applicant's CRA rating and the basis for the rating as well as the results of the applicant's subsidiary bank CRA examinations will be made public.

The requirement for written findings in every case imposes an undue burden on the Board and will unnecessarily delay the processing of applications and notices.

34. The Requirement for Civil Money Penalties May Not Be Justified in All Cases and Is Unduly Harsh

Proposed new section 11(j) provides for the imposition of civil money penalties on bank holding companies that fail to maintain an imputed rating of 3 or better or to comply with CRA commitments.

The threat of such penalties seems harsh in view of the comparative nature of CRA ratings under the bill. The CRA ratings of a bank holding company and its subsidiary banks may be susceptible to downgrading through no failure of the company or its subsidiary banks to maintain a consistent level of CRA performance but because of ever increasing CRA commitments applied to banking organizations with similar resources. The upward ratcheting effect of the CRA rating methodology can be expected to result in the eventual downgrading of a large number of bank holding companies.

Moreover, under the imputed rating system, a bank holding company may receive a below average imputed rating if only one of its subsidiary banks receives a rating of 4 or 5. Such a rating may occur for reasons outside of the company's control, such as circumstances involving regional economic distress or financial weakness due to fraudulent activity, computer malfunction, or disaster. None of these circumstances are taken into consideration in assigning imputed ratings.

Moreover, it is conceivable that bank holding companies may be subject to CRA commitments that become obsolete or impossible to fulfill (for example, if a particular community project fails for reasons unrelated to bank involvement) or the satisfaction of which would cause safety and soundness problems. H.R. 5094 provides no procedure by which an applicant may be relieved of such commitments but requires compliance with such commitments at the risk of incurring civil money penalties for failure to comply.

Section 11(e) requires new bank holding companies to commit to "maintain or improve" the CRA rating of an acquired bank with a 1 or 2 rating. The imposition of civil money penalties on a bank holding company whose subsidiary bank's rating drops from 1 to 2 for whatever reason is unreasonable.

35. The Collection of CRA Performance Data Imposes an Undue Burden and Provides Misleading Information

H.R. 5094 amends the Community Reinvestment Act to add a new section 808 requiring the development of a format for collecting data concerning bank community reinvestment activities. Such data is required to be evaluated and discussed in connection with each bank's CRA examination. (Report at 37). Banks with assets of $100 million or more will be required to make available data relating to the following:

1. Low- and moderate-income housing loans.
2. Small business and small farm loans.

3. Investments and contributions in community development projects, with separate categories for low- and moderate-income housing and small business projects.
4. Participation in government or private sponsored loan insurance, guarantee, or subsidy programs for housing, small businesses, or small farms.
5. The scope of efforts to market housing and small business loans in low- and moderate-income neighborhoods and minority neighborhoods.

The required data may provide a misleading picture of the community reinvestment activities of many banks because the nature and scope of local credit needs in a given area are not taken into consideration. Moreover, no category is provided for community reinvestment activities other than those listed, such as charitable contributions and other non-credit-related community reinvestment efforts. Community reinvestment activities of bank holding companies and their nonbank subsidiaries are not factored in.

The Committee Report accompanying H.R. 5094 indicates that the burden of collecting such data is intended to rest with regulators and their examiners. Banks will be required, however, to develop expensive programs for maintaining such data in readily accessible form. Contrary to the Report, most banks do not currently maintain such data in their computer systems.

Moreover, in order to accurately reflect a bank's community reinvestment activities, the required data must be coded according to the use and location of the proceeds. Loan data currently maintained by banks reflects the borrower's address rather than the location of where the proceeds are used. Such data may not reflect the community benefits of loans, for example, to small business proprietors who live in middle class suburban areas but use the loan proceeds to purchase equipment or inventory for a small business operation located in a low- and moderate-income inner city area and employing low- and moderate-income persons. Such loans frequently are secured by a mortgage on the borrower's residence or other personal assets and the loan data may not reflect the ultimate use or location of the proceeds.

In order to be useful in accurately measuring CRA performance, such data must be recoded in an extensive process involving review of voluminous loan files at each bank. Medium size regional banks may need to review tens of thousands of loan files, involving a tremendous expenditure of time and resources, in order to be able to provide meaningful data accurately reflecting their community reinvestment activities. Because of the weight given to such data in the CRA rating process and the importance of maintaining a favorable CRA rating in order to conduct normal activities requiring regulatory approvals, most banks will be forced to conduct extensive loan recoding efforts. Moreover, such an effort may involve reviewing loans that have been repaid in the recent past and are no longer on the bank's books since such loans nevertheless are indicative of the bank's community reinvestment commitment. Banks will need to maintain data on repaid as well as current loans in order to demonstrate fully their CRA performance.

36. Existing Agency Balanced Assessment Factors Are Deemphasized

The bill adds a new section 809 to the Community Reinvestment Act requiring written CRA evaluations of banks to be based on the existing

assessment factors in each supervisory agency's regulations implementing the Act. (Report at 38). The evaluation must discuss the facts supporting the agency's conclusions, including the performance data collected pursuant to section 808. The bank's CRA rating is assigned on the basis of the written evaluation, the nonconfidential portion of which is made public.

The existing agency assessment factors allow for a balanced view of a bank's community reinvestment performance. For example, the assessment factors permit the agencies to consider a bank's "ability to meet various community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors." 12 C.F.R. 228.7(k). Similarly, the agencies may consider "other factors that, in the [agency's] judgment, reasonably bear upon the extent to which a [bank] is helping to meet the credit needs of its entire community." 12 C.F.R. 228.7(l).

The agency assessment factors, however, are given secondary importance in CRA evaluations. H.R. 5094 requires "special emphasis" to be placed on a bank's record of "serving the housing credit needs of low- and moderate-income persons, small business credit needs, and small farm credit needs." Such emphasis is required in the statement, discussion, supporting facts, and conclusions of written evaluations. Unless a bank maintains a favorable record of making loans for such purposes, it is doubtful that the bank can earn a favorable CRA rating under the bill. Other significant community reinvestment activities thus may be discouraged, including health, education, and industrial revenue bond programs that may benefit the entire community.

The bill's CRA performance requirements thus deemphasize the flexibility provided by the current CRA review system to take into account the different nature of reinvestment needs in different communities and to allow each banking organization to perform its CRA obligations in a manner best suited to its operational structure.

37. CRA Activities of Nonbank Affiliates Are Not Accorded Appropriate Consideration

While H.R. 5094 holds bank holding companies accountable for favorable CRA performance, the bill does not give equal weight to lending or other community reinvestment activities of bank holding companies and their nonbank subsidiaries. Whereas the bill requires special emphasis to be placed on a bank's record of serving low- and moderate-income housing credit needs, small business credit needs, and small farm credit needs, a holding company's record of meeting such needs is given no similar emphasis and is not even required to be taken into consideration.

The bill provides that community reinvestment activities of bank holding companies, their nonbank subsidiaries, and holding company sponsored community development corporations "may be taken into consideration" during CRA assessments and ratings of affiliated banks. The bill does not require that such activities be considered or given equal weight with bank CRA activities. The failure to do so may force bank holding companies to artificially and inefficiently structure their community reinvestment activities.

38. The Rating Guidelines Lack Certainty as to Required CRA Performance Levels

The rating guidelines are not required by the bill to establish any definite criteria for attaining a favorable CRA rating and are subject to mandatory annual review by the bank regulatory agencies. The annual review

process may cause uncertainty as to the level of performance required for a favorable CRA rating from year to year. This uncertainty could cause delay in the implementation of community reinvestment programs and confusion in the examination process under which ratings are assigned, in addition to imposing an additional administrative burden on the regulatory agencies. An annual review seems an excessive requirement since the agencies will have normal discretion to review the rating guidelines as appropriate.

In conducting mandatory annual reviews, the agencies are required to take into account the views of community review boards and community and consumer groups. The views of banking organizations are not accorded the same preferential consideration. Since banks are directly affected by the guidelines and would be in the best position to provide advice as to the practical effectiveness of the guidelines, their views should be required to be considered.

The ratings themselves lack certainty. Under the bill, the Federal Reserve Board may modify CRA ratings in connection with applications and notices filed under the BHC Act based on the record developed in the application proceeding.

39. The Requirement for Separate Consumer Examinations Imposes an Excessive Administrative Burden and Detracts from Safety and Soundness

H.R. 5094 imposes substantial new requirements for the development and implementation of agency personnel and examination programs. The bill requires each federal banking agency to establish a separate consumer division responsible for conducting separate consumer examinations by consumer examiners specializing in assessing compliance with all consumer protection and community reinvestment laws. (Report at 41). This requirement involves an enormous and costly reallocation of limited examiner resources and agency funds and duplication of agency effort.

With current examiner resources in short supply, the required reorganization could have a substantial adverse effect on banking safety and soundness by diverting resources currently devoted to financial soundness examinations.

Moreover, the consumer examiners are not required to be trained in evaluating safety and soundness factors. The results of consumer examinations thus could conflict with safety and soundness examinations. A difficult burden will be imposed on banks to satisfy examiners operating under inconsistent mandates.

40. The Separate Consumer Divisions Will Duplicate and Confuse Existing Consumer Law Enforcement and Rulemaking

The bill requires the consumer divisions in each agency to initiate enforcement proceedings and to undertake supervisory actions to enforce compliance with consumer laws. This requirement unnecessarily duplicates the functions of the supervision and regulation divisions of the federal banking agencies. Moreover, the commencement of separate consumer-related proceedings and actions by a separate division could result in an uncoordinated supervision and enforcement program with respect to individual institutions, resulting in potentially conflicting agency actions and compliance requirements.

The bill also requires consumer divisions to develop and recommend proposed regulations to implement all applicable consumer laws. Such

regulations already have been promulgated by the Federal Reserve Board under the Truth-in-Lending Act, Fair Credit Reporting Act, Electronic Funds Transfer Act, Equal Credit Opportunity Act, and Expedited Funds Availability Act.

Under current law, only the Federal Reserve Board is assigned rulemaking authority for certain consumer laws whereas the bill appears to assign such responsibility to the consumer divisions of each agency. The bill casts doubt as to whether the Board's regulations could be superseded by regulations issued by the other banking agencies upon the recommendation of their consumer divisions. The requirement for each consumer division to develop and recommend consumer regulations could result in a potentially enormous rewrite of numerous existing consumer regulations with each agency adopting duplicative and inconsistent regulatory requirements. At a minimum, the bill suggests that the Board's regulations will need to be rewritten to reflect the recommendations of the agency consumer divisions.

41. The Community Review Boards Are Ineffective and Inappropriate

The bill requires the establishment at each Federal Reserve bank of community review boards with a broad mandate to review federal banking agency performance in administering consumer protection and community reinvestment laws and to recommend improvements in such performance. The community review boards are required to meet quarterly and to advise the agencies with respect to consumer concerns and community credit needs.

The review boards are not required to give any consideration to banking safety and soundness and indeed are not constituted in a manner that provides them with any experience or expertise in such matters.

The 16-member community review boards are comprised of 4 representatives of regulated financial institutions and 4 members from each of consumer, community, and civil rights organizations. No representation is provided for organizations representing other economic interest groups such as, for example, small business, farmers, labor, students, or local governments. The chairperson of each community review board is elected by majority vote of the members of each board, assuring that the chairman most likely will not be a representative of a regulated financial institution.

The review boards are not required to identify specific instances of unfulfilled credit needs, which could be their most useful function in assisting banking organizations in meeting such needs. The unbalanced composition of the community review boards will discourage use of these entities by banks as a forum for constructive efforts to identify unmet credit needs and develop effective community reinvestment programs.

The community review boards unnecessarily duplicate the function of the Consumer Advisory Council, which meets quarterly to advise the Federal Reserve Board on consumer issues. Moreover, the existence of 12 separate community review boards likely will result in a constant barrage of differing and conflicting recommendations to the Board and the other agencies, contributing uncertainty and delay in the development of effective agency programs for administering consumer and community reinvestment laws.

APPENDIX 2

ANALYSIS OF SUBTITLE C

"BASIC BANKING" AND GOVERNMENT CHECK CASHING

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE C - BASIC FINANCIAL SERVICES ACCOUNT

Background and Summary Analysis

This subtitle of H.R.5094 requires depository institutions to offer to the public basic bank accounts and government check cashing services to noncustomers. Mr. Chairman, let me first note that the American Bankers Association is sympathetic to the perceived and real problems which this subtitle seeks to address. However, we are concerned that the proposed solutions are unnecessary and inappropriate and will inhibit the development of alternative and perhaps superior remedies. Further, both the basic bank account and government check cashing service mandates impose intolerable risks and unfair costs on the banking industry in spite of the provisions included in the bill intended to reduce those risks and costs. The consequential costs of these mandated services are particularly burdensome for unprofitable and/or marginally profitable branches in low income areas.

With respect to basic bank accounts, we believe that many banks, especially large banks in urban areas, already offer such accounts. In addition, the bill fixes a uniformly structured account which may be too inflexible to respond to the specific needs of those seeking basic bank accounts.

Regarding the government check cashing service, we are concerned that the solutions proposed under H.R.5094 are not appropriate to the problem and may impose risks on the banking industry by requiring that we assume the good faith and proper identity of individuals presenting checks apparently drawn on government entities. Though H.R.5094 contains some measures intended to protect depository institutions against losses due to potential fraud facilitated by the bill, these provisions are inadequate. A high degree of risk persists under this bill irrespective of these additional sections. We must also note that many excellent alternative solutions to the check cashing problem are now available and other alternatives are emerging which are more cost-efficient, more convenient, and safer. Imposing a single, statutory method of access to government payments will inhibit such development.

Outline of Subtitle

This subtitle requires depository institutions to offer to the public "basic financial services accounts." The bill refers to "two-tiers" of this account, a basic bank account component and a government check cashing service component. In essence, depository institutions must offer two separate types of services: 1) a basic bank account; and 2) a government check cashing service for noncustomers. Customers may elect either service.

Under the bill, depository institutions must accept applications for either the basic bank account or the government check cashing service at all staffed offices. Applications must contain the application date, the name, address, date of birth, and handwritten signature of the applicant, and any other information the Federal Reserve Board ("Board") deems appropriate. In addition, the depository institution may require applicants to present a form of identification pursuant to Board regulations.

A depository institution may refuse to register an applicant if it determines that the information contains an "intentional material misrepresentation."

Basic Transaction Service Account.

To comply with the basic bank account requirement, the account must: be available only to individuals with less than $1,000 on deposit; assess service charges or fees not in excess of those set by the Board; not require an opening or minimum balance greater than $25; permit the use of checks or similar instruments for purposes of third party transactions; permit at least 10 withdrawals per month; issue either detailed monthly statements or a passbook; not mandate exclusive use of automated teller machines (ATMs). In addition, account holders may elect to receive regularly recurring payments by direct deposit.

Under the bill, depository institutions may close a basic bank account if the individual overdraws the account on three "separate and distinct occasions" within any six-month period or if the depository institution finds there to be a "pattern of fraudulent activity" involving the account.

Government Check Cashing Service.

The second component of the basic financial service account requires banks to offer government check cashing services for noncustomers. The application process for this service is the same as that for the basic bank account. The depository institution may reject an application if it discovers that an intentional material misrepresentation has been made on the application. The depository institution must cash any government check 20 days after application.

The depository institution may not condition the service on a minimum opening or minimum balance requirement or another account relationship. The depository institution may charge up to $2.00 to cash each check and must permit the customer to designate at least three offices where the customer may cash government checks upon presentment of appropriate documents and identifications.

For purposes of this Subtitle of the bill, a government check is defined as any check issued by: the U.S. or agency thereof; any state, regardless of the location of the depository institution; any agency of the state in which the check is presented; any unit of local government of that state or agency thereof.

Generally, a depository institution must cash any government check presented except it may refuse to cash a check if it has "reasonable cause to believe" that the check is being fraudulently presented or has been altered or forged or that the identification card has been altered or forged. In addition, the Board may suspend the check cashing requirement for "any classification of checks" if it determines that depository institutions are experiencing an unacceptable level of loss due to check-related fraud with respect to such class of checks or if there is reasonable cause to believe that a particular class of checks is being used in a fraud scheme.

Finally, the bill requires depository institutions to post notices indicating that the basic bank account and government check cashing services are available. These notices must clearly explain the features and limitations of the accounts so that customers are able to understand the terms of the accounts offered.

Analysis of the Basic Bank Account Requirement

Basic Banking Accounts Are Already Widely Available.

A large number of banks currently provide basic bank accounts. An Association survey conducted in the last quarter of 1987 shows that 52 percent of banks nationwide offer basic accounts, up from 44 percent in 1986.

A closer look at the survey data reveals that a much higher percentage of large banks (those with over $500 million in assets) offer such accounts. In fact, as the table below shows, over 70 percent of large banks voluntarily provide low cost transaction accounts. This is an important point, because these larger banks tend to serve urban populations where demand for low cost financial services is the greatest. It is also important to note that large banks hold 53 percent of the accounts and 63 percent of the dollar volume of domestic deposits. In other words, over 70 percent of the banks serving the largest number of urban customers are already providing low cost basic bank accounts.

Particular concerns have been raised regarding the availability of basic bank accounts for senior citizens. A 1988 survey conducted by Sheshunoff & Co. indicates that 78 percent of banks provide free checking to senior citizens. An additional 3 percent offer discounted checking services to seniors.

Banks Offering or Planning to Offer
Basic/No Frills Accounts to the Public
Percentage of Responding Banks

	Asset Size (Millions)				
	Less Than 50	50-100	100-500	500-1,000	1,000 or More
Offers "No Frills" Account*	51%	45%	61%	71%	71%
Plans Exist to Offer "No Frills" Account	3%	5%	10%	8%	14%

Source: 1987 Retail Deposit Survey, American Bankers Association, 1988

* No Frills accounts are defined as accounts that offer limited banking services to the general public at no cost or reduced cost. Typically, minimum balance requirements for these plans are low or nonexistent, and debt transactions and/or the number of checks written are completely fre or free up to a minimum.

Many of the available accounts demonstrate imagination and innovation in responding to customers' preferences. For example, the First National Bank in Albuquerque developed a basic bank account based on its market research. The resulting account assesses no maintenance or transaction fee nor any minimum or maximum balance requirement. Customers may choose to pay an additional $2.00 per month for overdraft protection. For an additional optional dollar, they may buy unlimited movie theatre tickets for half price.

The optional features of the account were in response to the bank's market research which concluded that fear of overdrawing an account and affordability of luxury items such as entertainment were top concerns for many individuals. The account has been marketed, in part, by bank representatives speaking directly to employees and management in factories, department stores, and other companies. The account is very popular, particularly among blue collar workers.

In its discussion of the reasons for including this provision, the Committee Report to H.R. 5094 cites estimates that nearly 20 percent of families maintain no bank account relationship. However, a 1983 study by the Board reports that while about 21 percent of families surveyed had no checking account, about 9 percent of those families did have a savings account. The study concludes that only about 12 percent of the households surveyed held neither a checking nor a savings account.

One Uniform Basic Bank Account Will Not Respond To The Needs Of All The Individual Markets And Will Inhibit Development Of More Responsive Accounts.

The proposed legislation mandates very specific features for basic bank accounts. Such a strict definition inhibits initiatives to offer basic bank accounts which may not fall within the parameters of the statutorily defined account, but which in fact reflect the preferences of those interested in basic banking accounts. For example, individuals in one segment of the market may be willing to accept a higher minimum balance or fewer permitted transactions per month in exchange for lower service fees. Others may prefer direct deposit of recurring payments if there is no minimum or maximum balance requirement.

It is difficult to determine which characteristics are most desirable or useful to those interested in a basic bank account. Currently, because many banks offer some type of basic bank account, customers may select the account which best suits their needs. Allowing the market to define the basic bank account will help to assure that the greatest number of people are accommodated. These innovations should be encouraged, not inhibited by a statutorily defined basic bank account.

The Legislation Does Not Adequately Protect Depository Institutions Against Fraud.

The two very limited safeguards included in the bill which are intended to protect depository institutions from fraud or mismanagement do not adequately shield banks from the potential fraud losses which the open accessibility of these accounts will inevitably attract. Virtually anyone may insist on an account.

While the bill allows a bank to reject an applicant if it finds an "intentional material misrepresentation," the bill lacks any provisions to enable a bank to reject based on knowledge that the applicant in the past has mismanaged or abused an account or otherwise defrauded an institution. The inability to reject an applicant on the basis of prior evidence of fraud or mismanagement is especially worrisome in light of the recent funds availability law requiring banks to release funds before they know them to be collectible. Undeniable multiple accounts and unfettered access to funds present an attractive combination to organized crime.

Ultimately, it may be impossible to translate a standard for denial of an account into statutory language. Such a standard would inevitably be too vague or too rigid. The standard "a reasonable cause to believe" used in the Expedited Funds Availability Act is inadequate because the test is too difficult to document and satisfy legally in genuinely threatening instances.

The Legislation May Unfairly Impose Costs On Banks.

While the bill permits the Federal Reserve Board to set permissible fees for basic banking services, it does not require the Board to set these fees at a level which assures that banks will recover their costs. In fact, the bill offers no guidance on how the Board should establish the minimal fees. Moreover, because different institutions will encounter different levels of account demand and different costs for providing the accounts, a fee set by regulation is not likely to be appropriate for each bank.

To the extent that the fee does not cover the costs of offering the account, banks will need to charge higher loan rates and fees on other services, and pay lower interest rates on savings products than those offered by our credit union and other nonbank competitors. For these reasons, some bank customers may shift to other financial service providers who are not subject to this bill. Because these other providers are accorded special benefits under federal law (for example, federal insurance for credit unions, federal SIPC account insurance for securities firms and exemption from federal antitrust statutes for insurance companies), it is not unreasonable to include them in any requirement to offer basic accounts if they provide transaction account services generally.

We believe that the market place should determine the fees and other characteristics of a basic bank account. Each bank should be free to ascertain the characteristics most in demand in its particular market, assess its own costs, and design an account accordingly. Banks may choose to operate these accounts at a loss as many currently do. As we stated earlier, over half of the banks in this country already offer some type of basic bank account.

Absorbing The Costs Of Basic Bank Services Would Threaten The Viability Of Thousands Of Unprofitable Branches, Particularly Those In Low Income Areas.

The additional costs of providing basic bank accounts, particularly in conjunction with a government check cashing service, will most significantly affect those branches located in low income neighborhoods which already operate at a loss or are only marginally profitable. Because demand for the basic bank accounts and government check cashing services could be particularly strong in these areas, the extra costs of the services may force banks to close some of these branches. Furthermore, banks may hesitate to open new branches in low income neighborhoods due to the burden of providing these services. Thus, the effect of providing basic banking and government check cashing services as mandated by the bill may make financial services even less available in low and moderate income neighborhoods.

A May 1988 study conducted by Booz Allen & Hamilton, Inc. concluded that about half of the nation's branches are potentially unprofitable. The report indicates that achieving profitability is even more difficult for small banks which lack the economies of scale enjoyed by large banks. The study also concluded that a reduction in the break-even expense levels has had the most significant impact of the economic viability of small branches.

The additional costs of providing basic bank accounts coupled with the costs of government check cashing services will clearly exacerbate the precarious financial condition of unprofitable branches. It will also strain the already pressured budgets of marginally profitable ones. The result will be more branch closings and fewer openings, especially in low income areas.

Analysis of the Government Check Cashing Service Requirement

The Legislation Would Increase Bank Exposure To Fraudulent Schemes And Current Losses Would Rise Dramatically.

Banks are reluctant to cash government checks for noncustomers for very legitimate and serious business reasons. Although there is little doubt that the United States Treasury or any valid government entity will pay properly endorsed, authentic checks, these government checks are not the equivalent of cash. For instance, governments will not pay counterfeit checks, checks endorsed by someone other than the payee, or altered checks. This means that the government will not reimburse a bank for a check which was stolen and falsely endorsed or a check on which the amount was altered. Generally, the bank may protect themselves by refusing to cash checks for strangers.

While some may argue that the current statistics reflecting losses from uncollectible Treasury checks are low, these statistics are not reliable for gauging the impact of the bill. First, they only represent losses from Treasury checks and do not show losses from state or local government checks. Second, and more important, they reflect losses experienced in an environment in which banks, and for that matter, other check cashiers, may protect themselves by refusing to cash checks for strangers.

Cashing checks for noncustomers on a selective basis is a deterrent which discourages cashing fraudulent checks. To argue that all banks should cash government checks for noncustomers because current losses are at an "acceptable level" is like arguing that the polio vaccination should be discontinued because so few cases of the disease are reported. In both cases, reason suggests that the "low" figures are the result of cautionary measures taken and not a justification for dispensing with those measures. Without those current preventive measures on which banks may choose to rely, losses from fraudulent government checks will increase dramatically.

An example of even a single case demonstrates the ease of fraud and the potential liability. Under the bill, a stranger may enter a New York bank and register for government check cashing privileges. Generally, the bank must cash any government check presented 20 days after application. The stranger may then walk into the branch with the proof of application and a counterfeit $1,500 check ostensibly drawn on the state of California. The bank, which has a very limited ability to verify the authenticity of the check, must pay the person $1,500 in cash immediately unless the teller has an articulative and precise basis to believe the check is fraudulent. When the check later proves to be uncollectible, the bank will likely never recover the $1,500 paid out; the person has no account relationship from which the bank may deduct the amount and the individual undoubtedly is not traceable. For small institutions in particular, even a modest sized check represents a significant loss.

The person could then continue to cash additional $1,500 checks at two more branches of the same bank. While the bill limits the amount of a single check, it does not restrict the number or aggregate amount of checks which the bank must cash. Thus, losses are potentially enormous. The individual could also have registered with several banks and proceed to cash counterfeit or duplicated checks in those branches. Under this scenario, rewards for the criminal are potentially very lucrative. Organized crime, in particular, would find the bill particularly useful and profitable.

The bill includes three provisions which attempt to limit the potential fraud, but these measures are only marginally helpful. First, the legislation allows a bank to reject an application if it discovers an "intentional material misrepresentation." While this may protect a bank if it somehow discovers that individuals have lied about their name or address, it does nothing to screen those who have in the past been involved in check fraud or other related theft activity. Essentially, the applicant's history becomes irrelevant.

Second, the provision which allows banks to refuse to cash checks which they have "reasonable cause to believe" are forged or otherwise fraudulent, offers minimal protection. The legal standard itself is difficult to meet, requiring a very exact explanation of a very firm and definable basis. Moreover, a flawed check may be difficult for a teller to detect, given the technology readily available for impeccable duplication. In our example, a teller suffers an added disadvantage because a New York teller may be unfamiliar with a California state check.

The final provision which attempts to insulate banks from fraud losses allows the Board to suspend any obligation to cash any check belonging to a "classification of checks" which the Board determines is causing unacceptable levels of fraud loss or which the Board has reasonable cause to believe may be used in a fraud scheme. The Board must report to Congress in the event it invokes this provision. Although necessary, this provision will be useful only in very unusual and unlikely circumstances. It would not be useful to attack the more immediate and common sources of government check fraud.

Depository Institutions Should Not Be Required To Subsidize Government Check Cashing Services.

The bill permits banks to charge $2.00 to cash each government check. This statutory price is somewhat arbitrary and is not based on a thorough knowledge of the costs involved in providing the service. Costs will vary greatly from institution to institution and from one geographical area to another. For example, for banks located in urban areas with large populations of government check recipients, the cost of overcrowded branches on government payment days may be far greater than for other depository institutions. Because government payments usually arrive on the same day for all recipients, branch overcrowding on payment days can severely strain the banks resources as well as inconvenience and alienate its regular customers. The minimal fee permitted by the bill simply will not adequately compensate for the costs of providing the service. These institutions then will be compelled to subsidize the service. This additional expense is one not borne by competitors.

Absorbing The Costs Of Government Check Cashing Would Threaten The Viability Of Thousands Of Unprofitable Branches, Particularly Those Located In Low Income Areas.

The additional cost of providing government check cashing services, particularly along side basic bank accounts, will most significantly affect those branches which are located in low income areas where demand can be expected to be high and which already operate at a loss or are only marginally profitable. The anticipated volume of demand and consequential costs may force banks to close some of these branches. In addition, banks may hesitate to open new branches in low income neighborhoods due to the burden of providing these services. Thus, rather than assisting those living in low income areas as the bill intends, mandating these financial services may instead reduce the availability financial services.

Direct Deposit, Electronic Access, And Other Emerging Programs Offer Reasonable Alternatives To Mandated Government Check Cashing.

In addition to possibly reducing the number of branch facilities available to those living in low income areas, the bill's provision may do further disservice to government check recipients by perpetuating a method of payment which does not best serve the beneficiaries. The bill promotes the paper check distribution of payments and thereby discourages the exploration and development of less expensive, more efficient and secure, and more convenient alternatives. For example, direct deposit payments into a recipient's account is a safe, efficient, and less expensive method to deliver payments:

- Recipients have immediate access to those funds. They do not have to wait for the check to arrive in the mail and then deposit it personally.
- Recipients are protected from theft of the check itself and theft of the cashed funds; this is particularly valuable to the handicapped and the aged. Recipients may draw funds as needed.

- Direct deposit encourages recipients to maintain accounts and thereby encourages savings.

It is also worth noting that although Treasury only began using direct deposit in 1975, by 1987, 46 percent of social security payments were made by direct deposit. The high percentage of social security recipients adopting direct deposit in a relatively short period presents persuasive evidence that social security recipients find direct deposit highly acceptable. These statistics effectively challenge the claim that social security recipients disdain direct deposit.

Other convenient and practical alternatives to paper checks are in the process of development. These programs rely on electronic payments, ATMs, and special access cards and, thus far, show great promise. For example, the results of a pilot program in Minnesota which distributes welfare assistance benefits electronically have been so positive that the pilot has been extended and it appears that it will become a permanent program.

Briefly, the Minnesota program allows recipients to access benefits from ATMs and operator assisted teller machines, using magnetic striped identification cards, personal identification numbers, and other means of identification. Of the approximately 700 participants surveyed, only 4 percent preferred checks, with 88 percent of participants preferring electronic delivery, and the remaining 8 percent expressing no preference. Preliminary findings show this pilot to be cost-effective.

The United States Department of Agriculture is examining proposals to test the electronic distribution of food stamp welfare benefits. Potential benefits of these programs include: a reduction in recipients' vulnerability to theft; reduction in distribution costs; earlier access to benefits; improved security from minimizing forgery; and reduced lobby traffic.

In New York City, public assistance and food stamp recipients now receive benefits through use of magnetic striped cards, eliminating the approximately 200,000 annual cases of lost or stolen benefits. The new system saved public assistance recipients $9 million in check cashing fees and reduced city administrative expenses by $11 million.

These programs are just a few examples of the current innovations and experiments which attempt to distribute government payments in an easy, safe, and cost-efficient manner. A further listing of some state initiatives is attached to this Appendix. The bill's mandate that depository institutions cash government checks for noncustomers drastically reduces the incentive to advance these new programs and instead perpetuates a system which is costly and inconvenient to recipients.

THE FOLLOWING STATES HAVE ESTABLISHED WORKING ARRANGEMENTS WITH BANKS OR OTHERS TO HANDLE DELIVERY AND/OR CASHING OF GOVERNMENT CHECKS.

Pennsylvania:

o The department of welfare has contracted with the largest commercial banks in the Philadelphia and Pittsburgh market areas for direct delivery of welfare checks (not electronic funds delivery) and food stamps.

o Bank participation is voluntary; at this point no thrifts participate.

o Welfare checks and food stamp authorizations are delivered **by mail** directly to participating banks according to zip code; the volume to be handled by each bank is arranged among participating banks in each area.

o Recipients are issued a photo ID by the state which is presented to the appropriate bank to either claim/cash their welfare check or receive their food stamps.

o The banks are indemnified against loss in cashing welfare checks provided that they follow proper procedures regarding IDs and endorsements.

o Participating banks receive a fee from the state for their services.

o The driving force behind the development of this program was apparently to reduce fraud rather than the inability of recipients to cash welfare checks.

New York City:

o The Human Resources Agency of New York City has contracted with Manufacturers Hanover and several New York check cashers to distribute welfare funds and food stamps to recipients.

o The city provides each participating M-H branch and check cashing facility with hardware for the electronic delivery of welfare funds and food stamp entitlements.

o The city issues recipients a photo ID with a magnetic strip containing information on the amount of funds and/or food stamps to which the recipient is entitled.

o The city pays participating institutions a fee per transaction.

o The driving force behind this program appears to have been to reduce fraud; reports indicate that it has achieved this goal.

Ohio:

o Summit County (which includes Akron and Canton) has established a voluntary pilot program for the cashing of public assistance checks.

o The county is responsible for issuing an ID card to recipients

o Each recipient selects a depository institution at which they wish to cash their check (up to three locations may be selected, not necessarily of the same institution) and the county supplies each institution with a copy of the ID card.

o The institution does not charge the recipient for cashing the check, and receives no fee from the county.

o There is no indemnification for fraud losses.

Minnesota

o The Ramsey County Community Human Services Department designed a pilot program for electronic delivery of public assistance payments.

o A random sample of about 1,000 AFDC and refugee assistance recipients was selected to participate in the pilot project.

o participating recipients were issued picture ID cards with magnetic strips encoded with the benefits to which they were entitled.

o participants could withdraw some or all of their benefits at selected ATMs and/or operator assisted teller machines.

THE FOLLOWING STATES HAVE ENACTED LAWS DEALING WITH CASHING OF GOVERNMENT CHECKS:

Connecticut: (law has passed but is not yet in force)

o Applies to all banks, industrial banks, and savings and loans. Credit unions are only required to cash checks for their members.

o Each institution must cash state-issued public assistance checks provided that the check is presented by the payee and that the payee has "reasonable" identification. The State Banking Commissioner and the Commissioner of Income Maintenance are currently writing the regulations regarding what constitutes "reasonable" ID.

o The depository institution may not charge the payee for cashing the check, but may request a fee from the State for cashing such checks.

o The State will indemnify the depository institution from loss on checks cashed provided that the institution follows identification procedures established by the State.

Massachusetts: (law passed in 1983)

o Requires banks and thrifts to offer free checking and savings accounts to residents over 65 and under 18 years old.

o Requires banks and thrifts to cash federal, state and local government retirement, social security and supplemental security income checks for residents provided the payee is registered with the institution.

o Each branch bank or thrift must offer registration for resident pensioners; upon verification of the information on the registration form, the bank must issue an ID card for a fee not greater than $5.00.

Rhode Island

o The statute requires all depository institutions to cash federal, state and local checks up to $750 if the person presents either a Rhode Island ID card issued by the Department of Transportation or a picture ID issued by the Department of Elderly Affairs.

o The institution may refuse to cash the check if there is reason to doubt the validity of the ID.

O Depository institutions have voluntarily agreed not to charge a fee for for cashing government checks

APPENDIX 3

ANALYSIS OF SUBTITLE D

BRANCH CLOSING ANALYSIS AND NOTICE REQUIREMENTS

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE D - NOTICE OF BANK AND THRIFT BRANCH CLOSURE ACT OF 1988

Background and Summary Analysis

Section D requires banks to give 90 day notice to its customers and the Comptroller of the Currency before closing a branch and submit detailed financial information if the Comptroller receives any non-frivolous comments about the proposed closing.

The provisions of this section imply that banks are choosing to close profitable branches which is simply not the case. A recent ABA study conducted by Booz-Allen and Hamilton indicates that as many as 40 percent of bank branches in operation today are not profitable and an estimated 50 percent of small and moderate sized ones ($20-$25 million) are losing money. If anything, this underscores that banks have tended to keep unprofitable ones open.

As the financial services industry has changed, the types of financial products developed and their methods of delivery have changed. Increased depositor sophistication and the deregulation of deposit interest rates have led bank customers to shift their funds out of low rate non-interest bearing accounts into market rate accounts and into investment products banks cannot offer. This shift has reduced the profitability of the industry as a whole and of many small branches in particular. Banks like other financial service providers must find ways to remain profitable. Imposing a complex and expensive procedure intended to inhibit bank branch closings will not help local communities and may in fact discourage banks from opening new branches.

Congress currently has an opportunity to make a positive contribution to the profitability of branch banking by allowing banks to offer a wider variety of products and services through their branches. Not only is there persuasive evidence that customers would benefit through lower costs and increased convenience, but expanding the menu of products that could be sold through branch offices would encourage more banks to maintain branch systems to serve the neighborhoods in their market area.

Overview of Subtitle D

Subtitle D would require national banks to provide written 90 day notice to the Comptroller of the Currency of its intention to close a branch. Customers of the branch must also be notified through a general notice posted at the branch and a notice inserted in at least one periodic statement that is mailed out. The notice must provide the Comptroller of the Currency's address and indicate that comments on the proposed closing may be mailed to him.

Within the 30 day period beginning on the date written notice is provided to the Comptroller, if he receives a non-frivolous comment regarding the proposed closing, the institution must provide a detailed statement (including statistics) of reasons to support the decision for branch closure. In addition, the institution must provide a financial analysis of loan activities of the past three years (including profits and losses); a projection of loan activity predicted at that branch for the future if the branch remained open; and a financial analysis of deposit activities (including profits and losses) for that same time period as well as a projection of deposit activity for the future if the branch was kept open.

The depository institution would be responsible for providing a detailed map of the facilities of other depository institutions in the community and a description of and location of any other facility that the bank believes another depository institution plans to establish in the area or that it plans to establish in the area.

The Comptroller must then make a determination if the branch closing will significantly reduce depository services in that community area. If that conclusion is reached, the Comptroller of the Currency would be required to consult with community groups to find ways to serve the community, including exploration of establishing a community development credit union.

Section D does not apply in instances where the Comptroller places a national bank in receivership or the Comptroller or the Federal Deposit Insurance Corporation authorizes another company to acquire the bank, thus affecting the branches.

Analysis

Subsequent Information Requirements

During the thirty day period from the time the Comptroller receives the written notice, if a non-frivolous comment is received from a member of the public, the bank must submit comprehensive financial information in support of the closing. The section fails to define what constitutes a "non-frivolous" comment thus increasing the possibility that this provision will be sweeping in scope and could place an excessive burden on banks.

Branch closing decisions already factor in community relations, concern for profitability and Community Reinvestment Act ramifications. To weigh this process down with extended notice and paperwork requirements could preclude banks from opening branches in marginal areas and could impact on the costs of services banks provide to consumers.

APPENDIX 4

ANALYSIS OF SUBTITLE E

TRUTH IN SAVINGS

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE E TRUTH IN SAVINGS

Background and Summary Analysis

Subtitle E on Truth in Savings requires depository institutions to provide uniform disclosures of interest rates and fees on deposit accounts and establishes requirements for advertising deposit accounts.

The American Bankers Association supports the subtitle's intent to assure availability of simple and understandable information which enhances intelligent shopping comparisons among accounts. But we have serious concerns over its failure to encompass mutual funds and ensure that credit unions will also adhere to rigorous disclosure requirements. Both entities are strong competitors for consumer dollars and as such should be fully covered by this subtitle.

By requiring comprehensive disclosures in media advertisements and civil liability for advertising non-compliance, advertising may be significantly reduced thus eliminating an important resource for consumer comparison shopping.

The legislation also requires a constant updating of transaction - specific information which could increase compliance errors and inhibit the development of new products with variable rates. In addition, it also permits state Truth in Savings laws to supersede a federal law, thus obviating the goal of uniform disclosures.

We are committed to providing consumers with clear and comprehensive information so that they may make educated decisions on which financial opportunities best meet their needs. However, inclusion of mutual funds, strengthening of credit union requirements and more realistic advertising requirements must be included to achieve an effective bill. With this in mind, we would like to make our recommendations regarding Subtitle E on Truth in Savings to help streamline the legislation and improve consumer information.

Overview of Subtitle E

Subtitle E on Truth in Savings disclosure and advertising requirements does not include coverage of mutual funds. It also allows, credit unions to avoid the comprehensive disclosure and advertising obligations by permitting the National Credit Union Association Board (which will be required to draft the credit union provisions) to take into consideration "the unique nature of credit unions and the limitations under which they may pay dividends..."

Disclosures of annual percentage yields, their effective periods, and annual rates of simple interest must be provided. If any change is made in a term or condition that could reduce the yield, consumers must be notified at least 30 days before the change goes into effect.

The disclosure provisions for depository institutions also call for broadcast, electronic media and outdoor advertisements to include a lengthy list of disclosures.

The subtitle prohibits depository institutions from advertising an account as "free" or "no cost" if a minimum balance is required or there is a limited number of transactions permitted or there is any transaction or regular service fee. It also precludes banks from placing inaccurate or misleading advertisements or misrepresenting deposit contracts.

In instances when a bank utilizes the investable balance method of calculation on consumer accounts, it must disclose the yield calculated on the full amount of principal in the account.

The subtitle provides the Federal Reserve Board one year in which to promulgate regulations after the law is enacted but does not indicate how much time depository institutions will have to implement the regulations.

There is civil liability for advertising non-compliance as well as disclosure non-compliance.

Federal law does not supersede state laws on Truth in Savings.

Analysis

Mutual Funds

To ensure that there are effective protections for consumers who are seeking to invest funds, it is essential that all financial institutions adopt the same standards for disclosure and advertising so that consumers may make comparisons not only among the regulated depository institutions, but among nondepository financial institutions as well.

Arguments can be made that mutual funds and savings deposits are legally distinct products since an investment in a mutual fund results in an ownership relationship whereas a deposit in a savings account results in a creditor relationship. However, from the viewpoint of the consumer, mutual funds and savings accounts are functionally similar: they offer an opportunity to obtain a return on savings dollars.

The regulations which were put in effect by the Securities and Exchange Commission on July 1, 1988 pertaining to mutual funds disclosures and advertising are an important step forward in assisting consumers in comparison shopping. However, they still permit mutual funds to provide important disclosure information in the text of the prospectus. We believe this will hinder consumers' ability to comparison shop among accounts inasmuch as the complexity of prospectuses inhibit people from looking through them. Therefore, we urge an amendment to Subtitle E which would require mutual funds to provide a separate document containing initial disclosures to be distributed along with the prospectus. This would greatly assist consumers in comparison shopping and would be consistent with disclosure obligations set forth for depository institutions. It could be as simple as reproducing the chart of information which will be in the prospectus.

We further suggest Subtitle E require the Board of Governors of the Federal Reserve System and other appropriate agencies to review annually the regulations under this subtitle and those prescribed by the Securities Act of 1933 to determine whether they are assisting consumers in their ability to comparison shop among accounts and investments.

Credit Unions

We are very concerned with subsection 451 which calls for the National Credit Union Administration (NCUA) Board to prescribe regulations for credit unions but enables them to take into account "the unique nature of credit unions and limitations under which they may pay dividends on member accounts...." Sizeable numbers of consumers use credit unions for their savings activities and should therefore be protected by a Truth in Savings law. This wording however could result in credit unions avoiding adequate disclosure and advertising regulations -- thus falling outside the regulations. In much the same way that we concerned with mutual funds being part of the legislation, we believe that the regulation must require credit unions to adhere to rigorous disclosure and advertising requirements to make disclosures and meet rigorous advertising requirements to ensure consistency in the marketplace and comprehensive protection for the consumer. We urge deletion of the phrases which address their "unique nature," etc. and propose clarification of specific disclosures which must be incorporated into credit union regulations so that they are truly comparable to the rigorous standards being proposed for depository institutions.

Broadcast, Electronic Media and Outdoor Advertising Exceptions

Subsection 443(b) permits the Board by regulation to exempt broadcast, electronic media and outdoor advertisements from three disclosure requirements if "any such disclosure would be unnecessarily burdensome." Those would be: the minimum amount of initial deposit required to open the account in order to obtain the yield advertised if it is greater than the minimum balance necessary to earn that yield; annual rate of simple interest; and a statement that regular fees or other conditions could reduce the yield if applicable. In reality, any disclosure requirement for radio and television advertisements would be burdensome. Therefore Congress should exempt them from all, not just some, of the disclosure requirements.

Broadcast and electronic media advertisements tend to run a mere 15, 30, or 60 seconds in length. As currently drafted, subsection 443(b) would require that those advertisements include a number of lengthy disclosures within this very limited time frame. This would not only confuse viewers and listeners, but would also detract from the advertisement's marketing value. Moreover, since the complete features of the account are eventually disclosed in full before the consumer makes a commitment, such disclosure requirements for broadcast, electronic media or outdoor advertisements are unnecessary.

Misleading Descriptions of Free or No-Cost Accounts Prohibited

We believe that Subsection 443(c) dealing with misleading descriptions of free or no costs accounts should be deleted. Although this is clearly a well intentioned provision, it would have the unfortunate effect of inhibiting the development of basic banking programs designed to benefit the elderly and poor.

It should be noted, moreover, that all industries including banking are already governed by general doctrines prohibiting misleading and inaccurate advertisements. Hence both subsection 443(c) on free and no cost accounts and 443(d) which generally prohibits misleading or inaccurate advertisements should be deleted.

Schedule of Fees

Subsection 444(a) requires that schedules be provided for each class of accounts offered by the depository institution. We suggest an amendment which permits depository institutions at their discretion to provide the schedule for each class either in the form of separate schedules or one comprehensive document. The current wording could cause confusion over the required format for such material. By permitting format flexibility, banks will be better able to serve the needs of their particular customers.

Calculation on Full Amount of Principal

We propose amending Subsection 447(a) which requires that the amount of interest accruing on an interest bearing account be calculated by utilizing the full balance for computation purposes. Its objective is to require disclosure when a bank is using an investable balance method of computation. If this method is being used with full disclosure, consumers may make the informed decision of whether they want to obtain such an account. However, the wording of this provision has resulted in confusion leading some to conclude that the House version of the bill intended to prohibit investable balance products rather than require clear disclosure. Therefore, we suggest that the sentence be rewritten as follows:

> "if the annual percentage yield is calculated on less than the full amount of principal in the account, then the depository institution shall be required to disclose what the annual percentage yield would be, if calculated on the full amount of principal in the account for the stated calculations period at the rate or rates of interest disclosed pursuant to this Act."

This would enable Subtitle E to achieve the goal of full disclosure of the investable balance method of computation while eliminating any confusion which the Board may encounter in attempting to translate the legislative mandate into regulations.

Updating Disclosures

The legislation appears to require current transaction specific information be provided to customers. This could be difficult to achieve since changes in terms rarely occur at the same time. It also increases the potential for errors being made in compliance. Adequate periods of delay for updating material should be provided to eliminate this problem.

Regulations

Subsection 448 while providing one year from the date of enactment of the subtitle for the Board to enact Truth in Savings regulations does not address the time frame for bank implementation. Haste in complying with new regulations increases the chance of errors and creates unnecessary expense. It results in confused and misinformed consumers. We suggest an amendment to specifically indicate that 180 days will be provided for enactment of regulations by the Board and an additional 180 days from the date of promulgation of the final regulations will be provided for implementation by banks. This will afford sufficient time for the Board to draft regulations and for banks to review them, develop forms, and train staff for accurate implementation.

Civil Liability

We strongly recommend that Subsection 450 be amended to exempt advertising non-compliance from civil liability. Advertising is often handled by outside vendors thus increasing the possibility of compliance errors regardless of how carefully the bank reviews the text before placing an advertisement. As drafted, the Congress would be obligating banks to provide remedies not just to its actual customers but to the wide universe of prospective customers as well. All of this could have the unwelcome effect of drying up advertising completely. This would negate the positive role that advertisements do play in assisting consumers in comparison shopping among accounts.

In Regulation Z, the Truth in Lending Act, civil liability provisions for disclosure non-compliance closely resemble those proposed in the Truth in Saving subtitle. Realizing the potential problems that could result, the Truth in Lending Act however has exempted advertising non-compliance from its civil liability section. We urge legislators to provide the same exemption in subsection 450 of this legislation.

State Law

The objective of Truth in Savings legislation is to provide for uniform disclosures which will enable consumers to comparison shop more effectively. With the increasing number of bank mergers and acquisitions, achieving such consistency in disclosure will be unattainable if state laws are allowed to supersede federal law, as has been proposed. Congress is best equipped to craft legislation on Truth-in-Savings to cover all states activities. To permit state law to supersede federal law could cause consumers unnecessary confusion as to whether the information they have received from Bank A is really comparable to that received from Bank B. Therefore, we would urge that this section be amended to reflect federal precedence in Truth-in-Savings laws.

APPENDIX 5

ANALYSIS OF SUBTITLE F

HOME EQUITY DISCLOSURE

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE F HOME EQUITY LOAN REQUIREMENTS

Background and Summary Analysis

This legislation would amend the Truth in Lending Act to establish additional disclosure and advertising requirements for Home Equity products and make some substantive changes in them.

We believe the substantive provisions regarding circumstances under which a creditor may terminate credit or change terms unilaterally are realistic. However, provisions of this subtitle which require excessive disclosures and burdensome advertising requirements will confuse the consumer and make it increasingly difficult for creditors to offer this highly popular and effective product.

There is a laundry list of disclosures and a booklet which the creditor must provide each time an individual takes an application form. Some of those disclosures should be deleted because they are unnecessary, others should be placed in the booklet for handy reference and to eliminate confusion from a flood of material.

Creditors will be obligated to include extremely detailed information in their advertising in all but the most generic advertisements. We believe that this will confuse consumers particularly in instances such as television or radio spots where the advertisement is very brief. It will virtually chill marketing as well.

Failure of Subtitle F to provide for a federal home equity disclosure and advertising law to supersede state laws jeopardizes efforts to ensure consumers will receive consistent information on home equity products. It will also make it difficult for banks which market home equity products on a regional basis to comply.

The American Bankers Association shares Congressional concern in protecting consumers from the loss of their most important possessions -- their homes. We believe that home equity financing products must be used wisely and carefully and we are committed to seeing that happens. But without revisions to the disclosure and advertising provisions, it will be difficult for creditors to continue to offer their current products. The following are our recommendations for the legislation.

Overview of Subtitle F

Subtitle F would require extensive disclosures on or with home equity line of credit applications including each fixed annual percentage rate (APR) imposed in connection with extensions of credit or, in the instance of variable rate APRs, a description of how they will be computed and changed. The subtitle also requires a 15 year historical chart showing how APRs and minimum periodic payments for each repayment option would have been affected by index changes used to compute the rate. It also requires creditor's disclosure of any of his fees and estimates of third party imposed fees. Explanations of negative amortization and balloon payments must also be provided if applicable to the account. In addition, the creditor must include a $10,000 example with a recent interest rate which shows maximum repayment periods if the consumer only made minimum payments.

The disclosure information must be provided to the consumer at the time he picks up an application form or before the end of three days from receipt of completed application by phone or one that has been distributed through magazines or other publications. At the time of the distribution of disclosure information, the creditor must also provide a booklet published by the Federal Reserve Board on home equity lines of credit or one that is substantially similar.

The subtitle requires the creditor to segregate the required disclosures from other home equity information and some key disclosures must take precedence over others.

The advertising section of the Truth in Lending Act, Regulation 2 would be expanded to increase the number of "trigger" terms -- those terms which obligate the creditor to include additional explanations in the text of an advertisement. It would also increase the amount of explanatory material which would have to be included when a term is "triggered." This would include information on loan fees and opening cost estimates; periodic rates; the lifetime annual percentage rate that can be charged; the current APR if a discounted one is mentioned; and other information established by the Federal Reserve Board through regulation.

The legislation prohibits creditors from unilaterally accelerating an outstanding balance except in specifically enumerated circumstances such as consumer fraud or material misrepresentation; the consumer's failure to meet repayment terms or any other action or failure to act by the consumer which jeopardizes the creditor's security interest.

It also precludes a creditor from unilaterally changing the terms of the agreement including freezing or reducing the line of credit except in specific situations such as a significant decrease in the value of the home; if the index used is no longer available; during periods of time when the consumer is in default; if the creditor has reason to believe the consumer cannot meet payment requirements; if government action would preclude the APR from being used in the account; or if government action affects lien priority.

Within 60 days of the enactment of the law, the Federal Reserve Board must prescribe regulations. Banks are to implement these within five months of their enactment.

There is no provision for the Board to publish model forms to facilitate compliance.

There is no federal preemption of state home equity disclosure and advertising laws.

Analysis

Disclosures

The provision requiring the creditor to disclose the maximum amount the annual percentage rate (APR) may change in any one year or to indicate there is no such limit should be deleted. First, the creditor is already required by regulation to disclose the lifetime cap for the APR, so the consumer has the most critical information on APR rates available in making a decision. Coupled with material from the chart and examples, this is more than adequate to assist in making a decision on whether a home equity product is suitable for his needs.

The creditor would be obligated to disclose the payment terms for advances and the period when repayments are to be made. It is unclear how a creditor would approach compliance if the advances had different terms from the repayment periods. The wording fails to indicate whether under such circumstances a creditor would need to provide separate sets of disclosures. Furthermore, if there is an array of options for advances and repayments, it is unclear if separate sets of disclosures would be required for each. Permitting creditors to use one set of disclosures for information on options and terms would enable them to avoid a potentially burdensome requirement. We suggest the right also be granted to allow financial institutions to utilize one form if they have multiple programs for home equity lines. This consolidation of paperwork would enable consumers to compare and contrast different plans, while assisting financial institutions in minimizing compliance costs.

The legislation also requires that telephone applications, or those from magazine and other publications or from a third party necessitate that disclosures be made before the end of three days from receipt of the application. We suggest amending this subsection to indicate that a bank is in compliance if before the end of the three day period it has placed the disclosures in the mail. The current wording could create some confusion as to whether the consumer would have to receive the information within the three days, something which could not be controlled by the lender if the process is being handled by mail.

We also urge amending the wording to indicate that the obligation to make disclosures as a result of a phone application arises from completed written applications. By requiring that phone applications be placed in a written form, it will reduce the likelihood of having to provide extensive disclosures to a consumer who merely inquires whether a home equity plan is offered.

The proposal that the creditor should provide a source of information on the index should be deleted inasmuch as other than being informed that the creditor will add a certain percentage called the margin to the stated index value to obtain the rate the creditor will utilize, little other information seems particularly helpful to the consumer.

The requirement that the creditor provide the consumer with a statement to ask about interest rate, index, and value should be deleted. Experience indicates that consumers, when provided with comprehensive disclosure material, want to receive the most recent information available on all aspects of the plan. The exception would be if the APR is a variable rate and therefore only described in the initial disclosures, creditors would then be amenable to suggesting that consumers ask about the current APR.

The legislation also requires creation of a historical table including the preceding 15 years worth of APRs and minimum monthly payments for each repayment option and how they would be affected by index changes. We do not believe that information dating back to 1977 would be particularly meaningful to consumers shopping for a home equity plan. Home equity plans are a relatively new financial product and historical rates such as lengthy history of interest rates and payments would not be an accurate indicator of what a consumer can expect in taking out a home equity plan in the current period of time. A table which covers a five year period of time would have greater educational value for consumers because the figures on it would be more accurate indicators of fluctuations.

Booklet Contents

Besides requiring a sizeable number of disclosures, Subtitle F also calls upon the lender to provide a booklet published by the Federal Reserve Board or one that has been developed which is substantially similar. Several of the initial disclosures such as information on negative amortization and balloon payments; instances in which the creditor has the right to change terms or terminate the loan unilaterally; the need to consult a tax advisor about the tax deductibility of a home equity loan; and the table showing a history of APRs and minimum payment amounts should be moved to the text of the booklet rather than requiring the lender to provide them on or with the application. This will eliminate the confusion which results when consumers are inundated with more than they want to know initially while providing them with a handy reference for later comparisons.

Model Forms and Clauses

We recommend that Subtitle F also include provisions for the Federal Reserve Board to publish model forms and clauses for common disclosures to facilitate compliance with the home equity subtitle. Concurrently, the provision should indicate the extent to which use of these forms will be deemed adequate compliance. Past experience with complex disclosure requirements indicates that model forms, while not serving every bank's needs, assist in achieving accurate compliance.

Advertisements

The advertising subsection would greatly expand those terms which "trigger" the obligation to provide additional information in the advertisement. In turn, banks would then be required to provide a laundry list of explanations. The Federal Reserve Board revisions of Regulation Z in 1981 included a simplification of the advertising sections "trigger terms" because the Board concluded that such revisions would not only improve compliance but would also "provide consumers with the information most relevant to credit shopping."

The proposal to expand the terms which trigger additional disclosures in advertisements could have a negative effect on the marketing of home equity products thus increasing consumer difficulty in comparison shopping among various home equity lines of credit. Other disclosure proposals coupled with current Regulation Z advertising requirements ensure that consumers would have all relevant information they need prior to concluding the loan agreement. Hence, what is being proposed for inclusion in the advertisements provision is unnecessary as well as confusing and should therefore be deleted.

Federal Preemption

The bill should provide for federal law to supersede any state law on disclosure and advertising home equity products. Without it, states could create a patchwork quilt of related but inconsistent or different laws that ultimately disadvantage the consumer and make disclosure compliance unduly complicated. Many financial institutions market home equity products regionally, and compliance with individual state laws would present unnecessary difficulties.

APPENDIX 6

ANALYSIS OF SUBTITLE G

EXPEDITED FUNDS AVAILABILITY AMENDMENTS

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE G EXPEDITED FUNDS AVAILABILITY AMENDMENTS

Generally, the amendments to the Expedited Funds Availability Act are extremely necessary and welcome. We particularly urge adoption of the amendment to allow application of all the exceptions to the next day availability schedule. The amendment will relieve banks from having to release unlimited large amounts of money on the day after deposit before they know the funds to be collectible. We oppose, however, the amendment in Section 471 related to payable through drafts.

We also recommend that Congress add to this list of funds availability amendments one to extend the period during which an account may be considered "new." The Act currently defines a new account as one opened within 30 days. We strongly believe that accounts should be considered new for at least the first six months.

Releasing funds from checks deposited into new accounts before a depository institution knows them to be collectible is a matter of great concern. Historically, banks have considered new accounts to be an area of great exposure and accordingly have imposed special access restrictions on items deposited in accounts held by persons with whom the bank lacks any experience. Traditionally, banks have viewed accounts held less than six months as "new."

New accounts pose risks because the bank does not know new account holders. The bank has no experience or relationship with the new account holders on which to base confidence in their ability or interest in managing an account. New accounts are more susceptible to losses because perpetrators of fraudulent check schemes rely on multiple accounts held by persons not long or well known to the bank and on the ability to withdraw funds before the bank knows the checks are uncollectible. Both of these elements now exist formally and universally by virtue of the Act. The change is more crucial if banks are required to open basic bank accounts to virtually all applicants as proposed in Subtitle H of the bill.

An amendment modifying the definition of new accounts to include accounts opened in the past six months would reduce the depository institutions' unfair liability exposure posed by new accounts.

Section 471. Treatment Of Certain Credit Unions As Local Originating Depository Institutions

This amendment provides that a check is deemed local or nonlocal for purposes of the funds availability schedule depending on which institution issues the check, not the one to which it must be sent for payment. We oppose this amendment very strongly and encourage Congress to pass an amendment to reverse the recent District Court decision which parallels the amendment contained in H.R.5094. Congress should amend the Expedited Funds Availability Act as follows:

Add at the end of the definition of originating depository institution, Section 602(17) of the Expedited Funds Availability Act, "or through or at which a check is payable, as prescribed by regulations of the Board."

This amendment would assure that checks and drafts are deemed local or nonlocal depending on the location of the institution to which the check or draft must be presented in order to receive payment.

The Act generally links the availability of deposits to the time needed for collection and return of checks, allowing longer holds for nonlocal checks which must travel further than local checks. Prior to the District Court decision, the regulations implementing the Act provided that a check is deemed to be local or nonlocal depending on the location of the institution where the check must be presented for payment. H.R.5094, however, provides that the location of the institution issuing the check determines whether a check is local or nonlocal, regardless that the check is not payable at that institution and that it must physically travel to a much further destination. For example, under this scenario, a California bank which accepts a check issued by another California institution, must treat the check as local, even though the check is paid by and must travel to a New York bank. Consequently, the bank accepting the check is undertaking a much greater risk that it will release funds which ultimately are uncollectible.

In addition, check processing technology depends heavily on the MICR encoding of items in order to route checks electronically and speedily to their destinations. Under the bill, depository institutions will no longer be able to rely on the machine readable codes on checks. Instead, each item must be reviewed by human beings to determine whether it is local or nonlocal. Such an exercise would inevitably and significantly slow down check processing, contrary to Congress' expressed intent in the Act that the Federal Reserve take all imaginable steps to modernize and accelerate the check payment system.

Further, retention of the current regulation will retard efforts to improve the check processing system by perpetuating and encouraging the practice of disbursing funds in areas remote to the issuing bank. This system promotes delay, inefficiency, and increased cost. The bill's provision should be deleted and the above amendment adopted.

Section 472(a). Safeguard Exceptions

This amendment expands the applicability of the exceptions to the schedules to checks which normally must be available the day following deposit. Currently, depository institutions must make the entire proceeds of certain deposits available for withdrawal at the start of the business day following deposit, irrespective of the amount of the check or that the depository reasonably believes the check to be uncollectible. The exceptions to the schedules for limited purposes, which are available for other check deposits, should also apply to next-day checks in order to control the risks of fraud which may result due to the inapplicability of these exceptions.

Section 472(b). Next-day Availability For Certain Deposits

This amendment limits the next day availability requirement for U.S. Treasury checks and "on-us" checks to checks deposited at a staffed teller facility. Congress required cash and other items to be deposited at staffed teller facilities in order to receive next day availability because it recognized that depository institutions need extra time to ascertain the contents of the deposits at ATMs and other unstaffed facilities and to update its books. These same considerations apply to Treasury checks and "on-us" checks.

Section 472(c). Notice of Exceptions

This amendment provides greater flexibility in the manner of giving notice to the depositor that an exception has been invoked. The Act requires notice to be provided to the customer each time an exception is invoked. In certain cases, it would be more efficient and less costly to depository institutions, as well as more useful to the customer, if the Federal Reserve Board had the flexibility to tailor the notice requirement to the exception invoked. For example, under the amendment a single notice to repeated overdrafters describing the special schedules applicable to the account for the time that the exception is in effect may be appropriate.

Section 472(d). Section 611 Civil Liability

This amendment delays by four months the implementation of the civil liability sections of the Expedited Funds Availability Act as it applies to certain sections of the Act relating to the disclosure requirements. It does not affect the effective date of civil liability as it applies to the availability schedules.

The current effective date of September 1, 1988 was simply too soon given the schedule of regulation publication and the time needed to review the final regulations and implement all the changes and requirements necessary to comply. The Federal Reserve has been very efficient in promulgating the regulations, but given the nature of the issue, the regulations are necessarily complicated and voluminous. The final regulations were only just published May 27, 1988, leaving little time for review by September 1, 1988.

Time is needed to review thoroughly the new regulations, to evaluate and determine policies, to develop and produce proper disclosure and notice forms, and to educate and train tellers and other involved personnel. We are concerned that banks and other depository institutions have not had sufficient time to assure absolute compliance in all aspects of this complicated regulation. The extension offers a "pardon" for noncompliance with respect to some provisions of the Act.

The amendment is consistent with the spirit of the Act as liability still applies with regard to the availability schedules. In addition, during this limited four month period, the Federal Reserve Board has full authority to address noncompliance of these sections if appropriate.

APPENDIX 7

ANALYSIS OF SUBTITLE H

EQUAL CREDIT OPPORTUNITY ACT AMENDMENTS

H.R. 5094

American Bankers Association
September 8, 1988

SUBTITLE H AMENDMENTS TO ECOA

This subtitle seeks to eliminate partial exemptions to the regulations implementing the Equal Credit Opportunity Act (ECOA) which apply to business credit. The proposed legislation is attempting to address the concerns expressed by minorities and women that they receive less favorable treatment than other applicants who apply for business loans. Their complaint is that business credit denial is, at times, not based on creditworthiness factors, but on the sex, race, or marital status of the applicant. The proposed remedy is to eliminate sections of the regulations implementing the Equal Credit Opportunity Act (ECOA) which exempt business credit transactions from certain procedural requirements.

The American Bankers Association believes that this legislation is unnecessary and rather than solving the problem of perceived business credit discrimination against women and minorities, it will inhibit the business lending process. It will also create burdensome and costly paperwork for banks which will make credit more expensive. The exemptions in the regulations are narrowly and carefully drawn and serve to recognize the realities of the business credit world. They do not increase or encourage the likelihood of wrongful prejudice. Eliminating them will not affect any perceptions of such prejudice.

Many of the specific complaints of women and minority business applicants are familiar to all small business owners seeking credit, regardless of sex and race. Access to credit is essential to the small business enterprise, but the credit process can be difficult. New owners of small businesses need practical advice on how to apply for and receive a loan. Thus the American Bankers Association has been active in educating new and small business owners, particularly women business owners. We have worked closely with various associations in this pursuit and have contributed to the publication and distribution of a pamphlet directed toward minorities and women. The pamphlet offers advice on applying for a business loan. We believe that the solution to credit access is not stricter regulation, but education.

The Ban Against Discrimination Mandated By The ECOA Already Clearly Applies To Business Credit.

Unfortunately, there are some misperceptions and misunderstandings regarding the scope of the Equal Credit Opportunity Act and requirements of Regulation B. Perpetuation of these inaccuracies does a great disservice to women and minorities in business seeking credit and could unfortunately result in discouraging them from proper pursuit of their rights. It may be useful then to clarify the existing regulations.

First, in spite of perceptions to the contrary, the ban against credit discrimination applies clearly and completely to all kinds of credit, both consumer and business. The mandate of the Act dictates this and the words of the regulations confirm it.

Secondly, the exemptions in the regulations are partial and do not extend nearly as far as some proponents of the bill believe. These exemptions do not permit business credit to avoid the mandate of ECOA; they merely recognize innate differences in the processes of evaluating business and consumer credit.

The first exemption relieves creditors of some, but not all, of the notification requirements. Creditors must notify business applicants of adverse action either orally or in writing. No explanation is required at this point. However, creditors must provide a written statement of the reasons for denial upon request of the applicant. This compares to be consumer credit situation where notice of adverse action must be provided in writing. At that time, the creditor must also either indicate the reasons for the denial or advise the applicant of its right to know the reasons. Thus, even in business credit applications, creditors are required to provide the written reasons for denial; the applicant need only ask.

The second exemption pertains to the retention of application records. Generally, creditors must retain records of applications for 25 months. However, in the case of business applications, records may be discarded after 90 days unless within that period, the applicant requests otherwise. As the regulations indicate, business credit records still must be retained for at least three months and are not exempted completely from the record retention requirement.

Finally, the exemptions provide that creditors are not subject to the general prohibition against requesting information concerning marital status in the case of business credit. Normally, however, because most business credit is secured by personal and business assets, a creditor is permitted to request the information regardless of this exemption. Nevertheless, the exemption in no way gives creditors license to base the credit decision on this information. To do so is a clear violation of the statue.

The Exemptions For Business Credit Are Only Partial, Justified By Business Practices, And Adequately Protect Applicants.

These exemptions, then, are not broad and far-reaching. Furthermore, the exemptions are justified and adequately protect business credit applicants. They were adopted by the Federal Reserve Board after extensive notice and comment and have been subject to periodic reviews. Hearings held produced no evidence to show that the exemptions harmed a single person. The Federal Reserve Board has concluded on review that no change in the exemptions is necessary, it continues to keep the subject open for further discussion and reevaluation if it is necessary.

The purpose of the exemptions is to recognize and protect the innate distinctions in the processes of evaluating business and consumer credit. Regarding the notification process, a creditor must notify an applicant of its decision to grant or deny credit, regardless of whether consumer or business credit is involved. Like the consumer credit applicant, a business credit applicant is entitled to know the reasons for denial. However, the business credit applicant must formally request that the reasons be provided. This compares with the case of consumer credit where the creditor must either: 1) explain that the reasons will be provided upon request, or 2) automatically provide the reasons for adverse action. Typically, creditors automatically provide consumer credit applicants a standard form which indicates the reason for denial because this is the most efficient way of complying with the requirement and is most helpful,to the consumer. Unusual reasons for denial of consumer credit are easily explained on a standard form, and automatically providing the reason for denial is less burdensome than coping with inquiries from consumers which come long after the credit decision has been made.

Business credit transactions are more complex and involve much more negotiation than is true with consumer credit. Business credit evaluation is both a quantitative and qualitative analysis that requires understanding the business involved. The reasons for a business credit decision are specific to each business and applicant, unlike consumer credit where the reasons for denial are far more standard and predictable.

Furthermore, because business credit applications and evaluations often demand several personal appearances, the applicant and creditor have both the opportunity and incentive to discuss the reasons for a decision, cures for inefficiencies, alternatives, and counteroffers, making a written notice of reasons unnecessary. This contrasts with usual consumer credit transactions where the application could be made by mail or even telephone, and where there is little opportunity or need for an in-depth discussion or negotiation.

Elimination Of The Exemptions May Harm Rather Than Aid Business Credit Applicants.

If the exemptions were eliminated, the resulting regulations could damage rather than improve the business application process. Creditors, if required, could adopt a standardized, model format indicating in a concise manner the reasons for denial, but the notice could well be much less informative and less helpful than a personal discussion. Although the applicant is still free to discuss the loan in person, there is much less incentive to do so, having already received a notice of denial which inevitably suggests finality. Effective negotiations need the opportunity for spontaneous discussions back and forth between the parties.

The written notice also may discourage a creditor from making a counteroffer rather than an outright denial because it is more awkward and difficult to commit to new terms without additional information and further discussion, an impossibility without personal contact with the applicant.

Finally, the adverse action notice itself may become a discouragement to business applicants, particularly small business applicants. Under the regulations, every counteroffer is an "adverse action," a type of denial which requires notice to be sent to the applicant. Under the present regulations, this notice may be presented orally in the case of business credit. Without the exemptions, the regulations would require that the creditor send written denial notices each time it makes a counteroffer, written or oral. Because business credit negotiations may involve numerous counteroffers, an applicant would then be badgered by constant notices of "adverse action," a discouraging prospect for a new, hopeful business entrepreneur, particularly when the notice cannot practically present the complete picture or possible alternatives.

While proponents of this subtitle tend to focus on the difficulties encountered by new and small businesses, Congress should not ignore the impact of the legislation on bigger, established businesses. These businesses would be deluged with adverse action notices during the course of what they view to be negotiation of a simple loan. Undoubtedly, these companies would find the repeated adverse action notices for each written or oral counteroffer highly inappropriate and unnecessary.

The exercise would also create a burdensome and unproductive exercise for creditors. The additional paperwork required for a single loan, to a large or small company, could demand inordinate resources and expense.

The second exemption concerning retention of records is a minor concession to the realities of the business world. Under the present regulations, creditors must retain records of a credit application for 25 months. However, in the case of business credit, the creditor need only hold them for that period if the applicant so requests within 90 days after the notice of adverse action. The result of this provision is that a creditor must retain the records of the business credit application for at least 90 days in order to comply with the regulations.

Requiring retention of records for this longer period in general creates no new burden of compiling records. However, the extension of the time period may be a burden and cost for banks which are heavily involved in business loans and located in cities where storage space is scarce and expensive. Business credit application records are more voluminous and extensive than consumer credit applications. The cost of additional storage space could be expensive. Also, if a creditor is required to hold these records for a longer period and the applicant requests their return during the 25 months, the creditor has the additional expense of duplicating these voluminous records.

Complaints Of Women And Minority Business Applicants Are Often Explainable Or Echo The Complaints Voiced By Small Business Applicants In General.

The proposed legislation seeks to address the concerns of minorities and women seeking business credit who complain that they have received less favorable treatment in the credit application process than other applicants. Their specific complaints, however, are often explainable or are common complaints voiced by small business applicants in general.

For instance, a frequent complaint by women is that creditors require a spouse's signature on the loan documents before the creditor will grant credit. It is fallacious to conclude that this demand per se is sex discrimination. First, if the loan is a secured loan, that is, guaranteed by property used as collateral, the creditor is entitled under ECOA to require a spouse's signature. Indeed, prudent lending dictates this precaution. The reason creditors are allowed to require a spouse's signature in these instances is that a spouse may, either by joint ownership or by state dower law, have a claim to the property securing the loan. Under these laws, one spouse may not convey interest in the property without the permission of the other. To assure that it will have legal power to claim all property securing the loan in the event of loan default, the creditor must have the spouse's signature. This applies whether the applicant is a woman or a man.

Even the claim that a prenuptial agreement removes any claims by a spouse is insufficient to guarantee full legal claim to the collateral. Although courts generally accept these contracts, they are still subject to special scrutiny compared to other contracts and have been held void at times. The creditor cannot predict and cannot guarantee that a prenuptial agreement will be upheld under a court test and therefore protects itself with the spouse's signature.

Even if the loan is unsecured, that is, involves no collateral, the creditor may still require the spouse's signature if the applicant lives in a community property state, where, for example, the income on which loan repayment is based may be considered property owned by both spouses. The practice of requiring the spouse's signature is crucial to the integrity of any loan, consumer or business. The practice applies irrespective of the applicant's sex. The same demand is made of men.

Women and minorities also complain that they have difficulty securing loans to start a business. This is a complaint common to all applicants seeking start-up loans. It should be noted that, according to a National Federation of Independent Business report, sources of capital for starting a firm are substantially different from those used by a firm once the business operation has been established. All new business owners are more likely to rely more on personal sources rather than institutional lenders for the initial capital. Once established, the emphasis shifts from personal sources to institutional lenders, primarily banks. This finding is hardly surprising in view of the fact that lending to a new, untested business can be risky as evidenced by the number of small business failures each year. Lenders therefore must be particular and demanding when making such loans. They should be. They are not, after all, investors risking their personal assets. Rather, they are institutions responsible to their depositors and shareholders for making prudent loans which will be repaid.

Other common complaints of discrimination tend to be rooted in credit denial based on undercapitalization, insufficient income, and lack of management experience. These are all valid, prudent reasons for denying a loan or requesting additional investment by the applicant or another investor, particularly in the area of riskier small business lending. These factors are also factors that are applied to all small business applicants and not just to women or minorities. Other applicants voice the same complaints.

We would also like to point out that a survey commissioned by the Small Business Administration indicates that women business owners have similar experiences to their male counterparts in getting credit. Although the study was limited to established businesses, as we mentioned earlier, all new businesses generally are more likely to rely on personal sources rather than institutional lenders for the initial capital. Once established, banks are the primary source of credit for small businesses, according to the National Federation of Independent Business Study.

The Association Is Working To Educate Women And Minority Owned Businesses.

Finally, we would like to comment that bankers are interested in helping women and minority owned businesses and have been working with various groups in this pursuit. Women, in fact, are one of the fastest growing small business sectors and represent an important market.

We have assisted the Federal Reserve Board in drafting a pamphlet entitled "A Guide to Business Credit and the Equal Credit Opportunity Act." The pamphlet offers an explanation of the ECOA regulations along with useful advice on how to apply for a business loan. The pamphlet is available through various trade associations, including our Association. Sample brochures and applications have been widely distributed through Association committees and individual banks. In additional, members of various Association committees have been working closely with other industry groups, particularly the National Association of Women Business Owners (NAWBO), and the National Association of Bank Women to educate women business owners on the credit application process. Association committee members have participated and addressed audiences at NAWBO's national conference.

The Association is concerned about the complaints of minorities and women about the difficulty in finding credit for a new business. However, the law is adequate and fully protects them against discrimination in credit applications based on sex, race, and marital status.

We believe that the solution is not to eliminate the partial exemptions and thereby further antagonize credit negotiations. Rather, the solution is to inform these groups of their rights under ECOA so that if there is discrimination, they will know their recourse and to educate them about the application process to increase their chances of credit approval.

and counterproductive. We maintain that these provisions of title IV, as currently drafted, are unworkable and impractical.

Furthermore, considered against an abstract of Congress' historical reluctance to enact banking legislation that might unreasonably jeopardize the system's safety and soundness, we question the wisdom of hastily enacting requirements which might undermine the public's confidence in the system.

We at the national council are also concerned with the logic of including these CRA provisions as an apparent price tag for new securities powers. We feel that it is not only inconsistent with the fundamental structure and regulation of the banking system, but that it also potentially jeopardizes the system's safety and soundness.

The House committee has justified the stronger CRA requirements with the following argument: a concern that when banks get greater securities powers, they will concentrate more on securities activities and less on meeting consumer needs.

We believe that there is no basis in logic for this conclusion and disagree that enhanced security powers require more stringent community reinvestment laws.

It seems inconsistent to mandate that securities activities be executed separately from the federally protected activities of the bank, but require the bank to change its lending activities, presumably using federally ensured deposits, as a condition to obtaining security powers.

LIFELINE BANKING SHOULD BE ADDRESSED AT THE STATE LEVEL

The national council also believes that Lifeline banking issues are most appropriately and effectively addressed at the State level. In fact, several States, including Massachusetts, New York, Ohio, and my own State, have already enacted laws addressing government check-cashing regulations.

Connecticut law, for instance, requires that all financial institutions taking deposits within the State cash public-assistance checks. These checks must be presented by the recipient, and proper identification is mandatory. An account with the institution is not required, and the individual is not obliged to pay a fee when cashing the checks.

In addition to that, the larger depository institutions voluntarily began a Lifeline banking program in 1987, which was so successful that no Lifeline banking bill was introduced in the 1988 session of the General Assembly.

In conclusion, Mr. Chairman, we respectfully suggest that a sufficient case has not been made for the passage of title IV of H.R. 5094. We believe that not only banks and savings institutions but consumer groups as well will benefit from a structured investigation into this matter, complete with the appropriate statistical research and hearings.

We thank you for the opportunity to present this testimony today.

[The complete prepared statement of David J. Sullivan, Jr., follows:]

Statement of

David J. Sullivan, Jr.
on behalf of the
National Council of Savings Institutions

before the

Committee on Banking, Housing and Urban Affairs
of the
Unites States Senate

on

CONSUMER PROTECTION PROVISIONS IN TITLE IV OF H.R. 5094

10:00 a.m.
September 8, 1988

Room 538, Dirksen Senate Office Building

INTRODUCTION

Mr. Chairman, members of the Committee, my name is David J. Sullivan, Jr. I am President and Chief Executive Officer of the Mechanics and Farmers Savings Bank, F.S.B., Bridgeport, Connecticut, a federally chartered, FDIC-insured institution with $1.2 billion in assets. I am testifying today in my capacity as the First Vice Chairman of the National Council of Savings Institutions. The National Council represents savings banks and savings and loan associations nationwide with assets in excess of $550 billion.

The National Council wishes to take this opportunity to express its concern over several of the provisions of Title IV of H.R. 5094, the Depository Institutions Act of 1988. At the same time, we offer our suggestions for developing a workable alternative that will address both the legitimate concerns of the Congress and the practical realities presently facing banking institutions. Our specific concerns are directed toward the provisions dealing with community benefits, access to financial services, and notice of branch closings. I wish to emphasize, however, that the National Council does not oppose H.R. 5094; we do oppose Title IV of the bill in its present form, but believe that given time compromise solutions can be adopted.

Inasmuch as our principal objection to Title IV relates to its community reinvestment provisions, I would like to begin by challenging the basic assumption underlying Title IV of the House bill: that deregulation has encouraged depository institutions to turn their backs on the communities in which they conduct deposit-taking activities. In Bridgeport, Connecticut, for example, the business community has coalesced behind a community development program that has produced excellent results, and I would like to take a moment to describe this program.

Bridgeport, Connecticut, is the smallest city in the United States in which three separate Neighborhood Housing Services ("NHS") agencies have been established. Presently, the first office, on the East Side of Bridgeport, has completed its work leaving intact a functioning neighborhood self-help organization. Currently, NHS offices are operating in the West End and South End of the city. Approximately 80 percent of the $189,000 operating budget for 1988 has been supplied by the depository institutions within the city. The first NHS program in Bridgeport was founded by my predecessor at Mechanics and Farmers Savings Bank, F.S.B., the late Edward R. Kasparek. I had the privilege of serving as the first President of the South End NHS. The depository institutions have provided strong leadership to these agencies, which have accomplished a great deal in the rehabilitation of residential housing within our city.

The Bridgeport Neighborhood Fund (the "BNF") is a more recent addition to the agencies, assisting people within low- and moderate-income neighborhoods to find housing. BNF was created in part through funding by the Ford Foundation and the General Electric Corporation. In response to a $50,000 challenge grant to the city of Bridgeport, the three savings banks headquartered in Bridgeport joined to provide the matching $50,000 funding and provided $3,000,000 in below-market-rate loans to subsidize low- and moderate-income housing. At present, a total of seven depository institutions are providing funding for these loans that total approximately $6,000,000. The current operating budget for BNF is $100,000, of which $70,000 is provided by the depository institutions.

Sharing responsibility and leadership by the depository institutions and the residents of the neighborhoods in which these organizations are functioning is a very important factor in the success of the NHS and BNF agencies in Bridgeport. The involvement by bank personnel at the grassroots level has led to a greater understanding on our part of the housing needs in the low- and moderate-income areas, and has simultaneously developed an awareness and recognition on the part of the city's residents of the need for responsible credit usage and cooperation within the neighborhood to improve its housing.

We respectfully suggest that within the city of Bridgeport, the depository institutions have recognized their responsibility to assist in providing affordable housing financing in low- and moderate-income areas by their involvement, both personal and financial, with these agencies.

HISTORICAL BACKGROUND

Traditionally, the primary objective of banking legislation has been to ensure that the banking system is safe and sound. The safety and soundness requirement has been imposed for several reasons: most notably, to protect depositors from loss of deposits and to prevent bank failures; thereby ensuring confidence in the banking system and preventing major disruptions in the money supply. Since banking institutions are unable to make loans or perform other functions without generating deposits and other investments, maintaining public confidence in the stability of the banking system as an investment vehicle is thought to be a paramount and imperative objective. Balancing the ability to attract deposits with the responsibility of redirecting the funds back into the community has likewise been an important feature of the Nation's banking structure.

To protect the public's funds and ensure safety and soundness, state and federal banking authorities rely primarily on the examination of depository institutions from the standpoint of credit quality. In fact, federal legislation of banks and savings institutions has always been designed with a view toward establishing a structured and workable system of examination. A study conducted by the Senate Committee on Governmental Affairs in 1978 concluded that:

> the principal justification for bank examination has been and, in a real sense, continues to be the early detection and subsequent prevention of unsound and unsafe banking practices [and] the Congress has determined that both stability of the nation's banks and competition among them are the pre-eminent goals of bank regulation.[1]

Only recently has Congress expanded the dominion of banking legislation beyond the basic safety and soundness responsibility to impose affirmative lending requirements on depository institutions with a view toward increasing the viability of urban communities through coordination of private investment, federal grants, and insurance. We support this public policy goal and, as I have indicated, we view our industry's record as one of willing and good faith compliance.

The Community Reinvestment Act of 1977 (the "CRA"), enacted as part of the Housing and Community Development Act of 1977, represents Congress' most concerted effort to date to provide consumers with available credit opportunities. Consistent with the language originally contained in the Banking Act of 1935, the CRA encourages banks and savings institutions to meet the credit needs of local communities they serve, consistent with safe and sound practices. Enforcement of the CRA has been successfully

administered by integrating its requirements into the existing regulatory structure with its continued emphasis on safety and soundness.

SUMMARY OF POSITION

Mr. Chairman, I testify before you today to suggest, in the first instance, that no additional community reinvestment, life line banking, or bank closing legislation is necessary at this time. Moreover, the National Council believes that to enact this legislation now, without further study or research, would be imprudent and counterproductive. We maintain that that these provisions of Title IV, as currently drafted, are unworkable and impractical. Furthermore, considered against an abstract of Congress' historical reluctance to enact banking legislation that might unreasonably jeopardize the system's safety and soundness, we question the wisdom of hastily enacting requirements which might undermine the public's confidence in the system.

It is imperative, then, that Congress analyze this legislation in contrast to prior banking initiatives to determine whether such an overwhelming impact on routine discretionary decisions is desirable and wise. We urge the Senate Banking Committee to take the initiative and have Congress study the issues presented in this legislation with a view to determining whether a credit availability problem, in fact, exists. Only by holding hearings and conducting a thorough investigation will Congress be able to craft a law that will adequately address any public needs in a way that Title IV of H.R. 5094 fails to do. Members of the National Council would be pleased to participate in and support such an investigation in any manner that the Congress requests our assistance.

Community Benefits

As indicated, the National Council of Savings Institutions questions the need for the inclusion of the CRA provisions of H.R. 5094. The Community Reinvestment Act of 1977, enacted in order to increase urban revitalization and prevent redlining practices, has been well assimilated into the extant regulatory framework; it has been effective in ensuring that banks and savings institutions continue to meet the needs of the communities they serve and whose deposits they hold. Moreover, as interstate banking gains momentum, states have begun drafting and enforcing legislation to prevent certain neighborhoods and smaller communities from being denied credit opportunities from the larger, out-of-state institutions that have no historical connection with these communities.

The arguments advanced by the proponents of an expanded CRA are based on statistics which indicate that a large portion of financial institutions receive an acceptable Community Reinvestment Act rating (the "CRA rating") from their respective regulators. These individuals further argue that very few merger or other applications are denied as a result of unsatisfactory CRA ratings. The National Council believes that the present examination process has sufficiently executed the legislation's stated purposes of encouraging financial institutions to meet the credit needs of their communities, consistent with safe and sound banking practices. Moreover, we have seen no recent authoritative study or other equally definitive evidence that indicate a trend or pattern of redlining or other discriminatory activity.

On March 23, 1988, this Committee received testimony from the federal regulatory authorities on their CRA enforcement activities and results.

The testimony submitted by Federal Reserve Board Governor Martha R. Seger explains that, "The Board chose in the early years of the law's existence to emphasize obtaining commitments for future improvements when presented with a record that had specific areas of weakness."[7] The Board intended to use its assessment criteria to make the CRA process an integral part of the institution's management and operational decision making without attempting to set standards for the type and amount of lending required. Governor Seger opined that the Board believes lending decisions are best left to the lender's informed judgment, taking into account the market situation, the lender's own business plans, and the community's credit needs. Moreover, she stated the Board premises that:

> as a general matter, working in a positive vein with these [potentially delinquent] institutions, rather than simply turning down the application was consistent with the law's mandate that we encourage these institutions to meet the credit needs of their communities.

The Federal Reserve Board's testimony also indicates that the evidence uncovered during investigations was often insufficient to support the conclusion that an applicant's CRA record was so unsatisfactory as to justify denying the application. In theory, the Board believed that both the lender and community benefited with a fair and workable community lending program.

Also on March 23, 1988, the U.S. House of Representatives Select Committee on Aging held hearings entitled, "Banking Reform: Protecting Low-Income and Older Consumers." At that time, the testimony submitted by Alan J. Fishbein, General Counsel, Center for Community Change, stated that:

> CRA and HMDA have helped to transform what was often an acrimonious debate over redlining into a more constructive dialogue between communities and their financial institutions over reinvestment needs and strategies. This more recent emphasis on local cooperation has led to the formation of many impressive reinvestment partnerships among lenders, community groups, and local governments. A 1985 survey by the Hubert Humphrey Institute of Public Policy in Minnesota found that as much as $3.7 billion in loan commitments for low-income housing and other community development projects are directly attributable to CRA and HMDA. We estimate that since then more than $1.5 billion of additional loan commitments have been made.[3]

> Mr. Fishbein's testimony continued:

> CRA gives standing to citizens' groups to challenge the approval of the bank expansion applications if they believe the institution is not meeting its CRA obligations. Community groups have taken advantage of the wave of interstate mergers and acquisitions by filing CRA challenges. While agencies are unlikely to deny these applications outright, a substantial challenge can force delays in processing, and thereby encourage negotiated settlement of the dispute.

Some scholars argue that discriminatory lending practices were never so widespread as to justify the 1977 legislation and thus are certainly unnecessary today. One argument, advanced by Dr. George J. Benston, maintains that there was an inadequate cross-section of the financial industry studied over a period of time that was too short to be able to conclude that a credit availability problem existed.[4] The argument reasons that by confining the studies to survey lending activity over a period of a year, it would have been impossible to determine whether the loans made during that period were representative of normal lending patterns. The author argues, as an example, that a low quantity of lending in a given geographic area may have conceivably been a reaction to over-lending in that area in a previous period. The thesis, like others, concludes that inmany instances lending activities in certain geographic areas was due not only to legitimate business decisions, but also to a lack of demand for credit.

Mr. Chairman, I mention this study not to lay claim to its definitive pre-eminence, but to suggest that other legitimate interpretations to lending patterns exist and must be explored further, especially if potential borrowers are to benefit. The decision to grant or deny a loan application is a complicated one involving many considerations, with profit being only one of them. Depository institutions, like other corporations, must answer to shareholders, independent investors, and general creditors who would not do business with that institution if not satisfied by the prudence of that institution's historical lending activities.

Insured deposits are an important source of funds, but they are no longer the sole source of funds for making loans — even for thrift institutions which, by virtue of their mortgage orientation, were able to channel deposits back into the communities they served in the form of loans. As a corporate executive, I am also bound by certain fiduciary standards and other business-judgment principles of corporate law that would hold me accountable for loans that are deemed unwise because they have no reasonable prospect of repayment. The consumer provisions of H.R. 5094 adversely impact on many other areas of corporate responsibility without adequately resolving them. The National Council believes that more time is needed to study the potential impact of these proposals and to try and reach a workable compromise rather than enacting Title IV outright.

The National Council is also concerned with the logic of including these CRA provisions as an apparent price tag for new securities powers. We feel that it is not only inconsistent with the fundamental structure and regulation of the banking system, but that it also potentially jeopardizes the system's safety and soundness. The House Committee has justified the stronger CRA requirements with the following argument: concern that when banks get greater securities powers, they will concentrate more on securities activities and less on meeting consumer needs. We believe that there is no basis for this logic and disagree that enhanced securities powers require more stringent community reinvestment laws.

Depository institutions enjoy the protection of the federal government in many ways. Most noted is the protection given to certain deposits by federal insurance funds. Also important is the access to either the Federal Reserve discount window or the ability to obtain credit advances from the Federal Home Loan Banks. For the certification enabling banks to have access to these privileges, the Banking Act of 1935 required banking institutions, unlike securities institutions, to serve "the convenience and needs of the community." This requirement has been routinely interpreted to include a community's credit needs as well as its deposit needs, and has never been objected to by banks or savings institutions that apply for these privileges. Although no similar language appears in the Home Owners' Loan Act of 1933, courts have consistently held that the declared congressional purpose in establishing a home loan system was to provide for thrift institutions in which people may invest their funds and to provide for financing of their homes.

Members of the House and Senate Banking Committees have devoted much time and effort to the pending bills. Particular attention has been given

to certain safeguards thought necessary to ensure that depositors at federally insured facilities are not at risk because of securities activities undertaken. Thus, the new securities activities are to be conducted through a separately capitalized subsidiary of the holding company. Other firewalls have been included by both the House and the Senate to prevent a bank from extending credit to its securities affiliate; to prohibit interlocking directors or officers between a bank and its securities affiliate; to require full disclosure that bank-underwritten securities are not federally insured deposits; and to prohibit a securities affiliate from dealing in the mortgaged-backed securities backed by its own assets unless rated by a non-affiliated company.

It seems inconsistent to mandate that securities activities be executed separately from the federally protected activities of the bank, but require the bank to change its lending activities (presumably using federally insured deposits) as a condition to obtaining securities powers. We do not believe that the authorization for new holding company powers should be contingent on fulfilling additional requirements under the CRA.

Most alarming are the impact that this quid pro quo would have on public perception and on its impact on the safety and soundness of the banking system. It would be more difficult for banks, and especially savings institutions with a substantial presence in certain areas, to attract much needed outside capital from investors. An investor seeking a profitable return would hardly be encouraged to invest if a financial institution were being forced to lend certain amounts of money to high-risk borrowers for no reason other than their geographic location. This quid pro quo is even more ironic when it is considered that Congress historically hesitated to grant securities powers to banks because it

The CHAIRMAN. Well, thank you very much, Mr. Sullivan.

Mr. Rideout, Vice Chairman Johnson of the Federal Reserve Board, as we have just heard, in his prepared statement said that there are two criticisms of the existing CRA process that should be addressed.

These are: No. 1, there is not enough opportunity for individuals and community groups to have input into the evaluation of the CRA performance of institutions; and No. 2, that high CRA examination ratings are commonplace.

Now, to meet these criticisms, Mr. Johnson recommends on page 13 of his testimony that—and I am quoting now:

> First, the appropriate Federal financial supervisory agencies should publish approximately every 2 years an evaluation of each financial institution's record of performance under the CRA.
>
> Second, the public should be invited to submit comments regarding this evaluation and the institution's performance record. As an essential part of the program, the Federal financial supervisory agencies should be required to take these public comments into account in reviewing expansion proposals of the institution.

Would you favor or oppose this proposal as a substitute for the CRA proposal in the House bill?

Mr. RIDEOUT. Mr. Chairman, I don't know at this time that there is a simple answer of favoring or opposing it. What we would like to do is to sit down with the Federal Reserve and sit down with members of your staff and members of your committee to discuss just what the design of this would be.

I think it is important that we have some discussion about what would be contained in the publication of CRA evaluation or CRA performance.

Let me give you an example. You might have a small town in Minnesota, some place like, for instance, Fergus Falls, MN, that has a small bank in its community, 10–12 employees, and through no fault of their own or through a comparative performance standard, something of that type that might ultimately come into law, would be assigned in a particular examination period, a rating of four. And they might have to publish that and it would become common knowledge in the community. And that could raise, I think, some serious questions among the members of that community about just the bank itself: is in fact the bank with an unfavorable CRA rating a safe and sound bank?

So, I think those kinds of questions need to be examined, but I think there certainly is some room for dialog on it, and I think perhaps that there is a way to work out a disclosure and comment procedure that would enhance the current CRA.

The CHAIRMAN. That is very constructive, and I appreciate that. In other words, you're saying that it is important that you get the disclosure and comment in such a way that it wouldn't endanger the safety and soundness of banks.

Mr. RIDEOUT. In other words, we could work it out in a way that does not endanger the bank and in fact encourages the community to continue to comment. I think that will help build dialog and help build CRA performance going forward.

The CHAIRMAN. Mr. Kolesar, I am encouraged that you believe public disclosure of CRA has merit. I understand you to have said that in your prepared statement.

Mr. Kolesar. That's correct, Mr. Chairman.

The Chairman. Could you provide some words of comfort to the panel of regulators that preceded you that it wouldn't lead to undue pressure on examiners to give banks low marks?

Mr. Kolesar. It would be difficult for me to offer comfort to them because I am not sure that I understand the source of their apprehension about that.

Is it possible—I'm sure it's possible, but I think if we just take the existing examination process, even just the safety and soundness exam, there are specific ratings given and it is of great importance to the bank that they receive, you know, a decent rating there.

I am not aware in my experience of any pressure within our bank, or any other that I am aware of through CBA, for those ratings to be in effect ratcheted up when the facts don't warrant it.

The Chairman. But if you don't give some low marks, if the rating doesn't carry any meaning.

I went to graduate school, and everybody got an A—which we all loved, but we all knew it didn't mean anything except it made our family happy.

Mr. Kolesar. That's correct, Mr. Chairman. [Laughter.]

But my own sense of that is that any comparative standard ought to be not vis-a-vis other institutions, even if that's within a peer group, but in terms of—and that's why we're calling for some local analysis of credit needs so that to solve the situation that Mr. Rideout was talking about of a small bank in Wisconsin, they should get a four simply because a small bank in another town is doing more? What are the credit needs in Cleveland and to what extent is the AmeriTrust Co. or National City or a society meeting those credit needs? Because there is, you know, in fact, a quantifiable objective there that I think that we all want to be able to meet.

So to that extent, no, it's not likely at all that Cleveland banks, for instance, are going to get a one. But I think it is conceivable that with the proper set of incentives, that you could have all six of the commercial banks in Cleveland doing a superb job of meeting local credit needs—not likely, but it's possible.

The Chairman. Mr. Culpepper, if the so-called Lifeline banking provisions of title IV of the House bill were amended to provide that thrifts could offer noninterest-bearing demand deposits, would the U.S. League be able to support the provisions?

Mr. Culpepper. Yes, sir. I think they would be.

I think this whole business is something that we wonder if it's really necessary. We are involved in looking after small accounts now. I think we are a little concerned about expenses. We are concerned about additional mandatory activities. We are concerned about edicts that come from on high while we face the struggle across the Nation.

And I think that ordinarily we would probably agree that along with the other financial institutions that if everyone was treated equally, we would accept it. But it's just bad timing right now for us to get involved in that type of Lifeline thing. And a lot of savings institutions already offer basic banking services.

The CHAIRMAN. Mr. Carruthers, you say on page 3 of your testimony that the IBAA believes that the Government check-cashing provisions in title IV of the House bill need further improvement.

SAME DAY AVAILABILITY OF FUNDS

Would the IBAA support the provision if it provided for the direct deposit of government checks and if the customer could have the funds on a same-day availability for withdrawal?

Mr. CARRUTHERS. That has been our recommendation. We are opposed to——

The CHAIRMAN. You recommend that?

Mr. CARRUTHERS. Right. We are opposed to requiring particular services. That is our biggest drawback from Congress mandating particular services, especially mandating the price.

In our own bank we established a policy of cashing government checks. We initially set the fee at $2. My experience over the last 12 months, with the fraud involved on down to netting only $1 in that check-cashing service.

So, we are taking a very hard look at the process we are going through and looking at if we are going to continue the service, of increasing the fee. It's just not reasonable for me to be required to provide a service that I can't make any money or actually lose money on.

The CHAIRMAN. Mr. Sullivan, you come from a wonderful State. I understand Bridgeport is the No. 1 metropolitan area in the country in income per capita.

Mr. SULLIVAN. Well, the statistical area, Senator, includes Fairfield County, and Bridgeport is the old industrial New England city which benefits from the income in the dairy ends in New Canaan. There is quite a difference.

The CHAIRMAN. That's right. That is why I was so surprised because I thought of Bridgeport as a marvelous town, but as you say, it's kind of a blue-collar town.

Mr. SULLIVAN. Yes, sir.

The CHAIRMAN. And not a town that was especially affluent. So, I was delighted to see that you were No. 1. [Laughter.]

Mr. SULLIVAN. Well, I was born in Bridgeport and I lived there all my life.

But we as a bank are very fortunate to have branches throughout Fairfield County as well as the city of Bridgeport. [Laughter.]

The CHAIRMAN. I understand Connecticut has had a mandatory check-cashing law on the books for several months. What has been the experience? Have fraud losses gone through the roof, or has it been reasonably good?

Mr. SULLIVAN. Well, actually, it has not gone into effect because when the legislature enacted the law, they set up requirements that regulations be promulgated which would give some guidance to financial institutions in cashing those checks, and the regulations now have been sent out.

The big problem that was involved in getting the regulations approved was the question of identification in check-cashing. Initially, there were a set of identifications. Two identifications were required, a drivers license and, for instance, a credit card issued by an oil company. That list has been narrowed down to, I believe it is, six secondary identification forms which are satisfactory, and we expect that will begin——

The CHAIRMAN. Any one of the six, is that it?

Mr. SULLIVAN. Yes, sir, plus the drivers license. Any combination of two if you don't have a drivers license.

The CHAIRMAN. So, you have not had experience under that law as yet; is that right?

Mr. SULLIVAN. But most of us cash checks, particularly government checks, for noncustomers upon officer approval or the branch manager's approval.

The CHAIRMAN. You don't anticipate, on the basis of your experience, any problem with it?

Mr. SULLIVAN. No, I do not, sir.

The CHAIRMAN. All right.

One other question for Mr. Sullivan, and then I will yield to Senator Riegle.

In March of this year Mr. Richard Hartwick, a senior vice president of the First Chicago Corp., appeared before the committee on our CRA oversight hearings. The following question-and-answer exchange took place between us:

> *Question.* Would disclosing your CRA rating trouble you at all?
>
> Answer: To be honest, I don't think it would be a serious problem.
>
> *Question.* The present CRA rating doesn't mean very much, does it?
>
> Answer: To be honest, it doesn't.
>
> *Question:* So, I would think that those banks that are doing a conscientious job would favor having a critical kind of a rating system. If a substantial number were given C's or D's or E's or F's or whatever, that would seem to me to be to the advantage of the banks that are conscientiously trying to do better. Is that right?
>
> Answer: I think it would. I think it would be an advantage.

The question is: Do you agree with the answers Mr. Hartwick gave to my questions in March and if you do, please explain why; if not, why?

DISCLOSURE OF CRA RATINGS

Mr. SULLIVAN. Well, speaking for our own institution, disclosure would not be a problem because I think we do an exceptionally fine job.

I do have some question about disclosure of ratings, and I share the concern that Mr. Rideout had. Once a rating of any type issued by a governmental agency is disclosed, the public has concern about it. And if you went on a 1-to-5 five ratio, for instance, and the bank was given a 2, which would be a very good rating, many people might get nervous and say why aren't they a 1?

The other thing that concerns me is that once you start that process, we might at some time in the future be faced with a situation where then building upon that disclosure provision we could very well get into public hearings in the community on your performance under CRA. And again, once that happens, you're open to all sorts of people coming in just to give you a hard time.

But basically, I really don't see the need for it.

The CHAIRMAN. Well, your answer is interesting, but I don't see any real difficulty, if you're doing a good job, why you can't explain it to your customers.

Mr. SULLIVAN. As a basic principle after the examination has been conducted and if disclosure—if the Congress said we had to do it, of course we would do it. I don't see that there would be any great benefit from it. Nor do I see that there is any great detriment.

We certainly would hear about any problems that come up on a regular basis. People come in and complain, I guess. We have never had any, but I know other perhaps have heard.

The CHAIRMAN. We have been joined by Senator Riegle. Senator Riegle has a special and deep interest in this. We have discussed it a number of times, and it is a matter of real concern in his State. He has been a leader on the committee, the leader on the committee in this area.

So, I am delighted that he is able to come. As I explained earlier, his wife is in the hospital and he would not be able to be here at the beginning.

Senator RIEGLE. Thank you very much, Mr. Chairman.

I appreciate your courtesy today and for reading my statement earlier. And I am happy to report that my wife had a good surgical procedure this morning, a lower back problem, and is doing well at this point. So, I am pleased to be able to be here at this hour.

I have not had a chance to hear your oral presentations, however, I have been reviewing your written submissions as I have been seated here listening to the chairman's questions and I appreciate the submissions that you have made.

I do have some questions to raise. They may duplicate some of the things that were said prior to my coming, but I would like first of all to pose a general question to all of you, and I want to take a second to phrase it. That is, I want you to react to the proposition, the question as to whether the Community Reinvestment Act concept, the whole idea of in a sense expecting that banks and savings-and-loan institutions will take—with a significant part of the resources that are generated within a community in terms of deposit base, in terms of business activity and so forth—should be expected to as a matter of public policy and good economic policy plow a certain amount of those financial resources back into those very communities from which those moneys come.

I would like you for the moment just to deal with the concept.

Some people I have heard say that banks and savings-and-loans are in business to make money. They have a fiduciary obligation to shareholders and depositors, and if there are less risky investments or higher profit investments somewhere else across the country, different State even outside the country, that they should move in that direction.

Others feel very strongly that that is—well, that would be one point of the spectrum—but the other point of the spectrum is that you are citizens of the community and the well-being of the community is importantly in your hands in terms of the investment decisions that you make and being in an area where your deposit base and your business base in large measure would be, in your own interest in the end to reinvest in full measure and in sufficient measure in the community.

I would like to hear each of you just react to your sense about the concept. Is this a concept that is sound? Is this something that feared that banks might dispose of funds indiscriminately or on risky ventures, as they did in the 1920s before Glass-Steagall was enacted. Why, then, is Congress now attempting to ask banks to commit money to certain areas without regard to the viability of the investment?

We are especially concerned about the so-called bell curve effect of the rating system required by H.R 5094 as currently drafted. The proposed provisions stipulate that the rating guidelines shall compare the performance of institutions to each other, thus requiring ever-increasing community reinvestment activities to receive an excellent or good rating. A failure to obtain a high rating would require a regulator to deny merger or acquisition activity and new asset powers; moreover, even currently authorized activities would be jeopardized.

Additionally, the operative provisions of this legislation contain no reference to safety and soundness considerations. For example, Section 810 of Title IV, Subtitle A, requires the development of a performance-rating system by federal regulatory agencies. Yet, the stated goal of this rating system does not require that the community reinvestment activities be considered "consistent with the safe and sound operation of the institution." The National Council believes that community credit needs must be balanced with safety and soundness considerations, as stated in the Community Reinvestment Act of 1977. Although there is limited mention of safety and soundness issues in the findings and purposes section, this hardly has the effect of law and inadequately addresses congressional intent. Loan officers and other banking executives need a clear indication of congressional intent in order to establish and execute workable lending procedures.

Access to Financial Services

The National Council of Savings Institutions is also concerned that inclusion of so-called lifeline banking services in any final legislation approved by Congress would be premature. Although the section understandably provides for a basic financial services account, it does not appear that the statistics presently available have been sufficiently reviewed to provide an accurate assessment of either the extent or the causes of the problem. In fact, results of the several studies conducted vary greatly. For instance, a study by the Association of Community Organizations for Reform Now found that only 12 percent of the institutions they surveyed cashed checks for non-account holders. By comparison, a study conducted by the Consumer Federation of America estimated that the percentage of institutions cashing government checks for non-account holders was closer to 29 percent, while a study by the General Accounting Office ("GAO") revealed that approximately 86 percent of all banks and 55 percent of all thrifts cashed United States Treasury checks for non-account holders.[5]

In Section 1001 of the Competitive Equality Banking Act of 1987 ("CEBA"), Congress required the GAO to conduct a study on the extent to which individuals who receive Treasury checks have difficulty cashing such checks. Although GAO was originally requested to survey the difficulty of individuals in cashing United States Treasury checks, it has elected to include state and local government checks in its study in order that its report's assessment be complete. We believe that Congress (and the consumer) would be better served by waiting for the results of the study than to pass any legislation before the study's findings are known.

Further, the National Council believes that these issues are most appropriately and effectively addressed at the state level. In fact, several states, including Massachusetts, New York, Ohio, and Connecticut, have already enacted laws addressing government check cashing responsibilities. The Connecticut law, for example, requires that all financial institutions taking deposits within the state cash public assistance checks. These checks must be presented by the recipient and proper identification is mandatory. An account with the institution is not required and the individual is not obliged to pay a fee when cashing the check.

In addition, as is the case in many instances when the federal government adopts a new law, inconsistencies develop with existing state law. For example, the State of New York prohibits savings banks and savings and loan associations from imposing any fees on checking accounts. However, H.R. 5094 would allow "minimal" fees for a basic financial services account that is intended to benefit low-income individuals and households. The immediate question which arises is whether federal or state law prevails in a situation such as this. The National Council would support federal pre-emption as the simplest way to deal with conflicts between federal and state consumer laws.

Should Congress determine that these issues are more appropriately addressed at the federal level, then it must see that certain precautions are taken in order to minimize the potential for fraud or other types of abuse. One such preventive measure might be to use a direct deposit method of transferring funds from the government to the recipient's account. This would reduce the risks that a government check might come into a forger's possession. This procedure would minimize the risk of inconvenience or loss to the payee.

Moreover, at a minimum, certain other changes are needed in this section of H.R. 5094. Most important, the bill fails to provide for a "means test" to determine whether an individual is entitled to open a basic financial services account. Although the availability of the proposed basic transaction services account is, in theory, limited to individuals with $1,000 or less on deposit at the institution, the statute as written fails to consider the individual's annual income or net worth. Furthermore, the subtitle requires an institution to open an account for those individuals who elect to use only the government check cashing services. This would unfairly impose increased costs on institutions by requiring them to maintain dormant accounts having no transaction activity.

In the explanation of the legislation, the House Committee states that depository institutions will be given the authority to close lifeline accounts on two conditions: consistent overdrafts and a pattern of fraudulent activity involving the account. Section 422(j) of Subtitle C likewise authorizes the Federal Reserve Board to suspend the obligation to cash government checks if it determines that depository institutions are experiencing an unacceptable level of fraud or there is reasonable cause to believe that a class of checks is being used to scheme a fraud. Nowhere in either the statutory language or the explanation does the House Committee indicate when overdrafts are deemed consistent or a pattern of fraudulent activity exists. Nor does the proposed law consider the amount of losses certain institutions — especially smaller ones — might suffer in proving fraud or consistency. Such a requirement seems especially egregious when considering that the Uniform Commercial Code severely limits banks' recourse against account holders and their ability to collect on instruments that travel through the collection system.

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Notice of Branch Closings By Bank and Thrift Institutions

The National Council of Savings Institutions believes that requiring depository institutions to undergo elaborate regulatory and public participation proceedings in order to close existing offices could be counterproductive in attempting to ensure that certain communities have convenient basic banking services. A financial institution may, in fact, decline to open or purchase a branch in a moderate- or low-income neighborhood if the burdens of closing that branch — or the risk that the money-losing branch may not be permitted to close — outweigh the potential benefits of investing in a certain community.

The provisions of this part of H.R. 5094 would require notification to customers of the branch and documentation to the regulatory authorities that would be both costly and burdensome to the institution. For example, a notice of the plan to close the branch is required to be inserted in at least one of any periodic statements of account that are mailed to any person who maintains an account at that branch. This obligation is in addition to the requirement that a notice be posted on the premises of the branch.

Moreover, should so-called non-frivolous comments be received by the regulatory agency in response to customer notifications, the financial institution is then required to submit extensive documentation, including items that would be difficult to verify, such as a projection of the deposit activity that could be expected at the branch in the future should it remain open. We find these documentation requirements to be burdensome, costly, and in some case extremely difficult to determine. Moreover, we fail to see the merits or the fairness in holding a banking concern hostage to a certain area while it continues to lose money on a daily basis. We concur with the House Committee's concern that some communities may be left without available banking services. We doubt, however, that the drafters of the language in the Banking Act of 1935 intended that a branch be held open while it continued to lose money and was subjected to the risk of high crime and vandalism so as to meet community needs. A compromise solution exists and must be reached.

CONCLUSION

Mr. Chairman, I cannot stress enough our industry's commitment to working with Congress to adopt viable legislation that will benefit the consumer without unreasonably jeopardizing the safety and soundness of the banking system. The National Council of Savings Institutions believes that because of the impact which the House Committee's proposals would have on the banking system, it is necessary to elicit and discuss all relevant theories, studies, and points of view in order to adopt a workable compromise. To that end, we maintain that it is important to consider the purpose and impact of prior banking reforms and legislative initiatives in comparison with the proposals presently pending before Congress to determine the impact Title IV might have on the safety and soundness of the banking system. At a minimum, a serious study of lending patterns, credit availability, credit demand, and redlining is necessary because no significant studies have been done recently that would justify this legislation.

The National Council of Savings Institutions commends the Congress for its efforts in this area. I can assure you, Mr. Chairman, that savings institutions have an equal if not stronger desire to locate untapped, credit-worthy, safe and sound lending and banking opportunities. We are concerned, however, that passing Title IV as a quid pro quo to receiving securities powers is extremely detrimental to the consumer. It would create an additional cost consideration for a banking institution: whether to enter into the securities field complete with its other start up costs and expected losses, and risky CRA commitments into certain communities, or to forego the securities powers in order to avoid the aggravation that Title IV presents. It has not been demonstrated that banking institutions stand to make significant amounts of money from the securities activities. Therefore, I would suggest that many institutions may decide to forego the opportunity, for reasons that are not germane to prudent banking practices.

The National Council of Savings Institutions does not wish to impede progress. To that end, we respectfully urge the Congress to pass H.R. 5094, but without the present Title IV. We believe that not only banks and savings institutions, but consumer groups as well will benefit from a structured investigation into this matter, complete with appropriate statistical research and hearings. We feel that there exists, at the very least, a reasonable doubt about the existence of a credit availability problem and the measures needed to correct the problem if it, indeed, exists. We ask the Senate Banking Committee to take the initiative to urge Congress to work with banking and consumer representatives in creating legislation that will benefit all concerned, without jeopardizing the safety and soundness of the United States banking system.

[1] Authority for this proposition may also be found at Dennis, "The Community Reinvestment Act of 1977: Defining 'Convenience and Needs of the Community,'" Banking Law Journal 95 (September 1978) 695.

[2] Hearings on the Community Reinvestment Act of 1977 Before the Senate Comm. on Banking, Housing and Urban Affairs, 100th Cong., 2nd Sess. (1988)

(Statement of Ms. Martha R. Seger, Member, Board of Governors of the Federal Reserve System).

[3] Hearings on Banking Reform: Protecting Low-Income and Older Consumers Before the House Subcomm. on Housing and Consumer Interests of the Select Comm. on Aging, 100th Cong., 2nd Sess. (1988) (Statement of Mr. Allen J. Fishbein, Esq., General Counsel for the Center for Community Change).

[4] George J. Benston, "Comments on the Community Reinvestment Act" (Paper presented at the Chicago Federal Reserve Bank's Annual Conference on Bank Structure, Chicago, 1979).

[5] Hearings on Government Check Cashing Issues Before the Subcomm. on Consumer Affairs of the Senate Comm. on Banking, Housing and Urban Affairs, 100th Cong., 2 Sess., (1988) (Statement of Mr. Richard L. Fogel, Assistant Comptroller General, General Government Programs of the United State General Accounting Office).

ought to be a matter of public policy? Do you feel comfortable with it in terms of it representing individual financial institutions or sectors?

COMMUNITY INVESTMENT

Mr. RIDEOUT. Senator Riegle, I would be delighted to begin the responses by saying first of all that the American Bankers Association and our member institutions very strongly support the intent and purposes and the premises of CRA as it was passed in 1977.

One of the underlying principles in that act was that the covered depository institutions were to help meet the broad credit needs—of their communities.

I think that banking has demonstrated that the current CRA framework has encouraged cooperation between community groups and banks. It has encouraged banks to do needs assessments, and to make decisions on their own, with safety and soundness as a primary consideration, to meet the needs of their communities.

So, I think this is happening, and we support it fully.

Having said that, I think it is important to recognize also that commercial banks do not necessarily represent the majority of funds flowing out of communities into financial intermediaries. In fact they represent a declining percentage of those funds. We have some statistics in my testimony that speak to that, specifically that banking's share of the funds flowing out of communities across the country has dropped from 40 percent in the early 1980's to 34 percent over the past few years.

I think what this reflects is the fact that we have a lot of different financial institutions, new kinds of players in the game who are operating in our communities.

I had a comment from a friend of mine yesterday who works for a community bank in Iowa. He said:

> One of the real problems we're having right now is with brokered CD's, with money brokers coming into our town and, in effect, siphoning community deposits out of our community off into CD investments in brain-dead savings-and-loans and other institutions around the country.

To the extent that we have other institutions in the markets who are siphoning funds out of our community, what is their legal responsibility to put funds back into these communities? I would argue really none—they are not subject to CRA.

And I think that is one of the serious problems and why it's important that we keep this concept of helping in perspective, because there is no way that any depository institution can fully meet all the credit needs of their community, because they simply do not have all of the resources of that community at their disposal.

Senator RIEGLE. Mr. Kolesar?

Mr. KOLESAR. Yes, Senator. CBA believes very firmly in that, that affirmative obligation that accrues to deposit-taking institutions, provided, of course, that we cling tenaciously to that deposit-taking franchise as the origin of that obligation to reinvest in the community. And like Mr. Rideout and ABA, we believe in it so strongly that we believe that that obligation accrues to other types of organizations that also suck deposits out of a community; specifically, insurance companies and mutual funds.

Senator RIEGLE. Now, just on that point, that is a differentiation because I took your comment to mean that you were talking about CD's where government insurance was underneath the CD. I mean, you mentioned savings-and-loans.

Mr. RIDEOUT. That's one example, but certainly there are many other kinds of financial institutions involved.

Senator RIEGLE. Well, that is why I stopped there because I want to make the differentiation which I hear you making, and that is that you are moving on over then into mutual funds and into insurance companies taking deposits who in a sense do not have the same financial arrangements and they are different kinds of entities; they don't have Federal deposit insurance as banks and savings-and-loans have in the same degree. And also, in terms of banks particularly, the access to the Fed I think creates a very different situation.

But given those differentiations, you are still saying that you think that some kind of test also ought to be applied to other deposit-takers that are taking money out of a community, including mutual funds and insurance companies?

Mr. KOLESAR. I do.

Mr. SULLIVAN. Senator Riegle?

Senator RIEGLE. Yes?

Mr. SULLIVAN. The national council certainly supports the theory of the whole Community Reinvestment Act, but I would like to elaborate on the other side of that obligation.

We are a very large—we are oriented toward mortgage lending, residential housing lending, and what we have found in the affluent market that we are in that Senator Proxmire commented on is that competitors come in who are nondepository institutions and they come in and take the loans in the very lucrative areas where there really is no credit risk, and the depository institutions are fulfilling the responsibility in the low- and moderate-income areas without any assistance from those who come in and skim the cream off the business in the area.

To my knowledge, there is no obligation on them to do it. We are faced with it and they are not.

Senator RIEGLE. Mr. Culpepper?

Mr. CULPEPPER. Senator, the U.S. League also strongly agrees with the concept. It has been in operation for a number of years. I think all of us have learned to live very well with the rules, and we are doing everything we can to support it and continue it.

But again, we are playing sometimes with one hand tied behind us because of these outside interlopers who come in and don't have to play by the same rules.

Senator RIEGLE. Let me raise one other question, and I don't want to go beyond my time here.

But in terms of the patterns that appear to have developed in some cities, there are some marked differences in loans to white applicants versus black or other minority applicants, but particularly black applicants. There are a lot of ways to calculate the figures with ratios in terms of deposits in, loans back, as one approach and so forth.

But there is enough data that has been collected and continues to surface—and I know we can talk about the methodologies as to how the studies are done—but there certainly seems to be some amount of evidence that would indicate that black citizens seeking loans of various kinds have a tougher time, especially in urban areas, getting access to credit or mortgages than either white people do or if they were living in other suburban areas.

Is there a problem in this area? And I would like a very frank answer.

Yes?

LOANS TO BLACK CITIZENS

Mr. Rideout. I would be very happy to address that with particular reference to the city of Atlanta, GA, where our bank has a banking operation.

There was press coverage in the Atlanta Constitution and Journal in early May, I think May 1 through 4, where there was a good deal of discussion about this and some statistics were presented.

Governor Johnson has submitted an analysis of that, and has concluded that the basic statistics they presented as to where banks were and were not making first mortgage loans were accurate.

But he also pointed out, I think very importantly, that whereas the Constitution reported that banks were making five times as many loans in white neighborhoods as they were in minority low-income and moderate-income neighborhoods, just the reverse was true with respect to home improvement loans—banks were making four times as many home improvement loans as they were making mortgage loans.

I think that demonstrates the fact that this whole question is very, very complex. For instance, the whole role of mortgage companies in single-family financing I think is a very important one.

In the case of my bank, we concentrate primarily on conventional mortgage lending within our bank, but we happen to own and operate the largest mortgage banking company in the South, which very actively solicits and makes FHA and VA loans in the kinds of neighborhoods that you are discussing.

So, I think those are the kinds of things that need to be carefully looked at. It's a very complex issue. In the area of Atlanta there are over 400 mortgage lending institutions, as I understand it, listed in the Yellow Pages. This would indicate that there are a lot of institutions out there, and many of them are providing very competitive lending in the form of FHA and VA loans.

So, I think one could argue perhaps that the single-family needs are being met, but not necessarily met by banks.

Senator Riegle. I appreciate the answer.

Let me ask you a little tougher question, and let me see just what your thinking is on it.

If, for example—take your bank in Atlanta and questions have been raised in Detroit, some are being raised in my hometown of Flint and so forth—if you were to find a pattern, say—and I don't want to get into the data that has been generated with respect to Atlanta per se here—but if you were to find that your black depositors, say, or your minority depositors who were whatever percent of your total business and in fact proportional to your other depositors the loan ratios, whether for new mortgages or for home improvement loans, there was substantial variance between these, if you saw that cropping up in your numbers, would that cause you to look at that issue and say to yourself, you know, maybe there's a problem, maybe they're not finding us, we're not finding them, maybe there are some blockages in the system?

How would you approach that kind of a situation if you found that to be the case?

Mr. RIDEOUT. I think we absolutely would go to work on it. We have a process within our bank where, on a statewide basis and within our major communities, we do periodic self-assessments with respect to how well we feel we are serving the various needs of the various markets we operate in.

But I think our analysis probably would go beyond just looking at first mortgages and it would go beyond looking at second mortgages. It would look at the total process of credit: What are we doing in the way of automobile financing, installment lending, and some of those others.

Senator RIEGLE. Right.

Mr. RIDEOUT. And there has been some work done by——

Senator RIEGLE. Small-business lending?

Mr. RIDEOUT. Small-business lending. All of that, I think, would have to come into the assessment that you did of your own institution. And I think if we found that we weren't getting the job done, we would go ahead and do some outreach marketing and put in place marketing-type programs that we would assure that would reach those markets.

Senator RIEGLE. I would hope——

The CHAIRMAN. Don, would you yield just for a minute on that?

Senator RIEGLE. Yes, of course.

The CHAIRMAN. Because this is a very interesting colloquy that you are having, and I want to read from the Atlantic Journal, which is not a communist paper, it's a fine paper. [Laughter.]

I am sure that some bankers might feel it is in view of this story by Bill Dedman. Let me read what Bill Dedman wrote:

> The Fulton County Commission chairman says he had to go to three banks last year to get a loan to add a guest house in Adams Park, an upper middle-class black neighborhood in southwest Atlanta. The first reaction of the bank was, "Why do you want to invest that much money in that neighborhood?" He said, "That's the neighborhood my house is in. If I, a powerful black elected official can't get a loan, what black person can?"
>
> James Fletcher said he couldn't, at least not from a bank. The 56-year-old retired Southern Railway laborer needed a $5000 loan to fix his roof. He owned a house in Mechanicsville, a lower-income black neighborhood in southwest Atlanta. Fletcher went in 1984 to Citizens and Southern Bank, his bank for 10 years. "They said they didn't make no house loans. They didn't let us fill out the papers."

Now listen to this:

> So he and his wife Lizzie May went to Atlantic Mortgage Co., which loaned them $5,773 at 18 percent interest plus $3180 in discount points and other add-ons, raising the effective interest rate to 27.1 percent, according to the loan papers. Total payback for that $5000 loan: $30,722.

Now, you can see that there is reason for blacks to be concerned about this and for feeling that there is real discrimination involved.

Mr. RIDEOUT. No question. I mean, when one reads that kind of an example, one immediately raises the question is this a pervasive kind of pattern, is this going on throughout the city of Atlanta? I think frankly that it isn't, although I am sure there are other exceptions just like that one.

The CHAIRMAN. He went to three banks. He went all over the place. He had to go to another institution in order to get the loan; not a bank.

Mr. RIDEOUT. Well, let me suggest this, Senator. The city of Atlanta is a great city. It has, I think, recognized over the years problems it has, and it has through public-private cooperation begun to solve those problems.

I think the reaction which the Atlanta banks have had to Mr. Dedman's story is typical of what you would expect in many communities—if there is a problem or if there is a perceived problem with respect to something like first mortgages, they pull together and do something about it.

In fact, prior to the announcement of that story, the Atlanta banks were working on a consortium which has finally been finalized, a $20 million, very competitive, very favorable program, which I am supplying for the record. And other Atlanta banks as well have come along with programs in this area, totalling, I think, upward of to $65 million in credit.

And I think what those programs will do is to demonstrate whether in fact there really is a problem, and I think if there is a problem, those moneys will be used up very rapidly and other moneys would be made available.

So, I think the banking system is prepared to deal with these problems, and is going forward to the extent that there are problems.

The CHAIRMAN. All right.

Thank you, Don.

Senator RIEGLE [presiding]. I'm wondering, you know, it raises the question, too, that if we've got problems that may be around the country in different areas, maybe worse in some areas than others, that it can help reinforce the downward spiral in urban areas.

Some really are struggling with that more so than others. And I can see why it would be difficult on the margin with the given loan here or there to try to decide whether the risk of repayment is too great because an area of town that is being looked at here is in trouble and maybe seems to be having more vacant homes and other problems in that area of the community.

FOREIGN LENDING

On the other hand, it seems to me that if we can speed up that downward spiral, if everybody backs away, especially depository institutions, and say, you know, I'd really rather be somewhere else where I don't have the headaches or the risk assessments or I just as soon would not have to cope with those problems, now I have to tell you that, from my part just looking back in time—I don't aim this at you, but, you know, we've invested an awful lot of money through the banking system in foreign countries—a ton of money that isn't being paid back.

There were big fees associated with a lot of those transactions over a period of time and everybody who pays attention knows we have some major foreign lending problems and banks, a lot of big banks, have taken write-downs, and so forth.

And, in a sense, you know, how we could get into a situation over a run of years where we were lending billions of dollars to foreign countries and foreign companies because of very high front-end fees and then watching a terrible recovery rate on a lot of those loans, and yet something that might be right across town or in our own neighborhood doesn't look too promising or a little tougher to sort of work the numbers on, and so forth, so then maybe we just, you know, tend to pay less attention to that.

I mean, when you look at the sheer flow of money, it looks to me as if over, say, a decade and a half, there's been an awful lot of money through our financial depository system that's gone into bad investments—bad investments overseas. We certainly have a huge problem with bad investments in the savings and loan industry right now. Some of it of course is very much a regional problem.

But, in a sense, when you try to put this in the context of an overall pattern, you know, I see phenomenal loss rates in some very large areas of bank lending over a period of years, and so I try to put that into the context of the question of inner-city lending, where lending in neighborhoods would seem to be in difficulty or, you know, maybe really struggling.

Somehow, it seems to me we've got to find a way to help those neighborhoods that can stabilize themselves and come forward, get stronger, to do so.

Now, I don't think that's solely the job of the banks. I think the Federal Government has a role and we've tried through a variety of publicly funded efforts with housing programs and UDAG programs and various other policy initiatives to try to strengthen urban centers, strengthen neighborhoods, try to get them turned around, help—extra help to schools, and areas like that, and so forth.

But I think the question of the degree to which banks take deposits out of the community and, in turn, put money back into the community, is a fair question.

And I think if the ratios get very far out of line where, on the one hand, we want the customer when the customer's bringing the money in the door, but we don't want the customer when the customer comes back and wants the loan for some improvement purpose or purpose that, in fact, is going to enhance the neighborhood or enhance an area, maybe strengthen the local economy, I think, if we start running into real dichotomies along those lines, that that's just wrong.

Thank you, Mr. Chairman.

Mr. Rideout, you wanted to respond.

Mr. Rideout. I would be happy to respond.

First of all, I would just reiterate.

Senator RIEGLE. And I don't mean to aim just these comments at you. Please understand that.

Mr. RIDEOUT. No. I really do appreciate the opportunity.

No. 1, I just would reiterate that I think and our association feels that the current Community Reinvestment Act is working toward the goal that you've enunciated. And I think it's a very laudable goal and one that we need to continue to work on.

The regulator panel that was here before has suggested some enhancements to the process within the existing law that perhaps would even accelerate us toward reaching the kinds of goals that you describe.

I think, with respect to your comment on foreign lending, it's a very legitimate question to raise. But I think there are two comments that ought to be made about that.

One is that the first big cycle of international lending was a result of the petro dollar crisis back in the early seventies and the need to recycle those petro dollars around the world because there was an imbalance between those who had the money and those who had the oil.

Not just the United States banks, but the European banks and, indeed some Asian banks were involved in that process.

I think another aspect of this foreign lending problem also has to do with structural problems which have existed in our banking system. And by that, I mean geographical structural problems.

As we begin to move into the nineties and we begin to move toward nationwide banking, banks will have a presence in broader market areas. This isn't to suggest that we still won't have a very fine and very strong small community banking system, but as some of the larger banks involved in these LDC loans are able to compete in the domestic market for deposits and loans, I think you'll begin to see the goals you talked about being achieved.

Senator RIEGLE. I'd like to just put another idea on the table. I won't detain you here because the hearing's gone on a long time this morning.

I think that between the burden of government coming in with targeted programs to try to help urban areas especially stabilize themselves, get stronger rather than get weaker.

And, on the other hand, to expect the private sector in every given instance to step in and to solve these problems, you know, occasionally we'll see that happen.

We've got a case right now in Benton Harbor, MI, where the Whirlpool Corp. has decided they're going to make a very major investment.

There are two communities side by side—St. Joe and Benton Harbor. Benton Harbor has been struggling for many years as a terribly depressed community—they've decided as a matter of a corporate decision that they're going to go in and help spearhead with the local community people a major kind of renaissance and economic restructuring, rebuilding.

And my hat is off to them. I think that's a tremendous step for them to take and I hope others will follow their examples other places.

But that's still relatively rare to see occasions of that kind.

I'm setting that up to pose a different kind of a concept for you. It seems to me one great strength you have as financial institutions is to be able to go in and make risk appraisals, to be able to assess the wisdom of an investment, the wisdom of a loan, whether it's to an individual, to a small company. We're talking about inner city or we're talking about minority borrowers or lending applicants, or what have you.

And it seems to me that if what you were able to find over a period of time, especially in very tough urban centers that are really experiencing great difficulty in getting stabilized and getting stronger, that you had a materially higher risk profile. And that if you were going to do business there, you know, maybe you couldn't even break even, let alone hope to make money.

If you were to suggest that maybe there's a way to think about some kind of a new partnership arrangement that is not the extreme of government coming in and doing it all or private sector in a sense being asked to do it all and doing very little of it because it isn't very attractive from the financial incentive point of view, to maybe start to say:

What we need is something that's a mix of these two things. Maybe we really need to craft a new tool, if we care about what happens to large urban centers.

Now, if we don't care about them, then somebody can say, well, you don't need anything. Just let it go the way it is.

I think we do care about them. I think it's profoundly in our national interest to care about them. And I think it's good economics. I think it's good for the national economy over the longer pull, good for people.

But, maybe what we need is to think about a way for professional lenders and risk assessors like those you represent to treat certain kinds of investment pools—and I don't relate this now either to minority lenders or to urban areas, per se, but however we might define a class of business that is a much tougher class of business and where the risks are higher—and to perhaps say:

What we really need to do is we need a little help with respect to carrying the risk, this profile of investment. That we're good at assessing it. We think we know how to do it. We think we know how to monitor it. We think we know how to get the payback over a period of time.

But, if our performance ratios are going to fall way below what we think we have to achieve across the full spectrum of our business in order to meet our responsibilities to shareholders and our responsibilities to depositors and to Federal Deposit Insurance, we would need some risk participation by the Government in a sort of risk pool arrangement.

And that we, speaking now as a large lending institution or a consortium in an area, would say:

Look, we're willing to take on a major additional role in this area, recognizing we're breaking new ground, it's tough, you know, because of the nature of the problems that are inherent in doing it.

But, if we had a way to do this in a way where because there is a public policy aspect, we could get a public policy participation in a risk pool arrangement so that we're sort of broadening out the shoulders on which that financial risk is carried, you know, we could maybe do a job that goes way beyond what we presently are doing, or feel that we can do.

Now, I can see why an awful lot of people would say:

Great concept, but don't bother me with it because I'm already losing my deposits. I've got other people coming into my community.

Somebody cited the fact that deposits are down from 40 to 34 percent, or some figure such as that, and we've got enough problems keeping our head above water without figuring out how we can take on new problems that are very tough on the margin.

I'd like to ask you to think about this idea because we've got some problems to solve as a Nation and if everybody says it's really not my job, it's somebody else's job, we're probably not going to get it done; because, in a sense, it's probably everybody's job.

We have to really think in some sort of a teamwork fashion if we really care about what happens on a broad base or what happens to everybody.

I think our trade deficit alone ought to tell us that the idea we can live with the notion of being disconnected from one another in our own society is—that's yesterday's thinking. It probably wasn't probably good thinking then but it is really counterproductive thinking now.

And I think there may be a way to start to move in the direction of thinking about solving this problem more aggressively on a shared basis where, in effect, you're not being asked to just take on a profile of risk that you may back away from because you think it's imprudent.

There may be a way to take and quantify that and get into some kind of a sensible risk-sharing arrangement that really lets some things happen.

I mean, the notion that any person, let alone large number of them, would get bounced around like the care where the chairman read about where somebody ends up paying 18 percent to put a new roof on their house, who presumably is credit-worthy and then paying the effective rate of 27 percent, I mean, I can't believe you want that. And I don't want that.

I don't think most people want that. We don't want it for ourselves and I don't want it for some guy across town that I don't know, regardless of who he is or what his circumstances are.

So why don't you give that some thought. Why don't you sort of think about that because I think we're getting to a point here where maybe part of the answer is to break out of the old boxes of the way we think about solving these problems.

Mr. SULLIVAN. Will you accept a comment on that, sir?

Senator RIEGLE. Yes.

Mr. SULLIVAN. You've hit the nail right on the head. We had from personal experience, I can tell you, that we started an Urban Lending Fund in our bank about 8–9 years ago and we borrowed from the Home Loan Bank of Boston Community Investment Funds. And we put about $30 million of mortgages into low and moderate income areas within the city of Bridgeport. The property had to be within that area to qualify.

We lost $3 million on that $30 million; by the time the foreclosures were taken care of, the defaults, that's what—and we passed that money along at 50 basis points. We didn't make a nickel on it.

What happened of course was when the examiners came in, the CRA examiners from the FDIC, said, "Boy, you guys are doing a great job." However, on the other side, they said, "Wait a minute, your capital is severely impaired. Your loss ratios are unacceptable," and it adversely affected our performance rating on the CAMEL rating, because of that very fact, that we were trying to meet our community reinvestment.

But, when push comes to shove and the safety and soundness of the bank are involved, you pay the price. And there was nowhere to turn. And at that time, we were about a $600–$650 million institution and that has serious impact.

So you have hit the nail exactly on the head; there has got to be a sharing of the credit risk.

Senator RIEGLE. Now, let me ask you this. In your example, apart from the $3 million loss on the $30 million worth of business——

Mr. SULLIVAN. That's a rough estimate.

Senator RIEGLE. Would you say that Bridgeport for the investment that you did make came out ahead for the ones that did work? I mean, you had some that didn't work, but you went out and you took some high-risk things.

So you laid in the $30 million worth of activity. I don't know how many projects it would have been.

But, did Bridgeport come out ahead or behind or the same place as a result of that?

Mr. SULLIVAN. Well, those were——

Senator RIEGLE. Irrespective of the loss factor.

Mr. SULLIVAN. Those were all individual residents, one to four-family mortgages. And I certainly think that, in one area where it was done in conjunction with the East Side Neighborhood Housing Services, it helped to stem the outflow within the neighborhood.

But we didn't get any credit for that.

Senator RIEGLE. Yes. Yes. Well, you're getting some credit right now.

Mr. SULLIVAN. Well, thank you, sir. [Laughter.]

I wish Mr. Seidman was here to hear that. [Laughter.]

Mr. RIDEOUT. Senator, may I——

Senator RIEGLE. Yes, but I just want to pursue this for a minute because let's take your example just in general, sort of generic terms. It may well be that you folks are well-positioned to find the opportunities that, on the margin, have a higher risk pattern but, nevertheless, probably ought to be done if we can find a way to deal with this dichotomy of risk here.

And you see, I just hypothetically—I don't even know the specifics beyond what you said of your example, but let's just take it as you've stated it.

It may well be that for the Federal Government to come in in that instance with a $3 million contribution to sort of pick up the loss factor, even if it's a break-even proposition, might be the most efficient way that we can get a great big bang for the dollar in terms of good beneficial community reinvestment activity per dollar spent.

Now, that requires a different way of thinking because normally we tend to take one fork of the road or the other. We say, Look, let's just have a government program straight out. You go that route, or you come in and say let's have the private sector do it straight out over here.

And it seems to me that you may have in a situation like that, if you had had a way to sort of come out of the hole financially, that we might have gotten a large amount of public benefit, long-term gain for a very modest amount of money.

And in a sense, you know, we would be using the established infrastructure. We'd use credit appraisers and others that you have in business today.

I don't want to suggest that that is a substitute for patterns that really look wrong and may very well be wrong in terms of the fact that not enough attention has been paid to certain kinds of problems in lending opportunities and lending needs.

But I think it's worth not staying trapped in the ways that we always think about these things. I think we have to go through that part of the discussion.

But then I think we have to say to ourselves:

Is there some other avenue that we can think of here that may be a hybrid approach that can move us faster: Get these loans out, get things squared away, stabilize neighborhoods, start to enable us to upgrade neighborhoods.

I'd like to know, too, how we can get more businesses to locate in these areas. Maybe we need an additional element of government help on the margin. We do that with the UDAG program in a somewhat different form.

But I think we need a different—I think we need to broaden out our creative thinking in terms of strategies that can really start to reinvigorate urban neighborhoods that are in trouble right now.

And it's not easy because you've got the drug thing hitting. You've got school problems hitting. You've got crime problems hitting, and so forth.

But people are living there every day and they want to try to see the situation get turned around. And I think it's in everybody's interest to find a way to get it turned around, not just walk away from it.

Anybody want to make a final comment, and then I'm going to——

Mr. RIDEOUT. Senator Riegle, I would just say very quickly that we are in the process of formulating with our association a community involvement task force that's going to be looking at a whole host of issues with respect to the community reinvestment problem.

And I will be sure to see that your suggestion is included on the agenda and we would like to spend some time with you talking about it, if we may.

Senator RIEGLE. I just say this for the record. The staff was pointing out that in a hearing that we had here back in March of this year, Mr. Kolesar stated at that time for the record, just from his vantage point, that the CRA loans had turned out to be generally pretty good loans.

Do you recall that?

Mr. **Kolesar**. Yes. Our delinquency ratios, you know, our bank exists exclusively to lend in low- and moderate-income neighborhoods in Cleveland. Our delinquency ratios are not disproportionately higher than they are in the lead bank and in some lending areas, they are in fact better.

What we have found is that our cost of extending those loans is greater because it takes the loan officer a lot more time to put these deals together.

But we don't see disproportionately greater risk there.

Senator **Riegle**. Very good.

Well, let me thank you all. There may be additional questions for the record.

The committee will stand in recess until 10 a.m. tomorrow.

Thank you all very much.

[Whereupon, at 1:16 p.m., the committee recessed, to reconvene at 10 a.m., September 9, 1988.]

PROVISIONS AIMED AT STRENGTHENING THE COMMUNITY REINVESTMENT ACT

FRIDAY, SEPTEMBER 9, 1988

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Graham, Garn, Heinz, and D'Amato.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we are holding our second day of hearings on the various consumer provisions contained in title IV of the bill reported out by the House Banking Committee on many of the issues dealt with in title IV not addressed in the S. 1886, the banking bill passed by the Senate.

It is, therefore, particularly important that we have these hearings in anticipation of the House-Senate conference to reach agreement upon a final banking bill this year. Our members must have the opportunity to hear the pros and cons of the consumer provisions adopted by the House Banking Committee.

Yesterday we heard from various Federal bank regulatory agencies and representatives of the various trade groups who represent the banking industry. That testimony was unanimous in criticising the House provisions: that they go too far; would be too expensive to implement; and with regard to the CRA provisions in particular, would lead to a government-ordained scheme for allocating credit.

I paid particular attention to testimony on the latter part because as author of the Community Reinvestment Act I have always contended that it did not call for and would not lead to the Government allocation of credit.

Instituting a government program allocating credit extended by private institutions would, in my view, be a mistaken undertaking.

Now, not all the testimony we heard yesterday was negative. Far from it. It was clear that many of the provisions in the House bill could be moderated somewhat and lead to good public policy results.

This was particularly true in relation to the provisions dealing with home equity loans, the cashing by banks of government checks, truth-in-savings, branch closings, and even Lifeline banking services.

I also noted that most witnesses yesterday agreed with the Federal Reserve Board's contention that the Community Reinvestment Act could be improved if it were amended to deal with two of its shortcomings.

Mr. Johnson, vice chairman of the Fed, identified these as: No. 1, there is not enough opportunity for individual and community groups to have input into the evaluation of the CRA performance of banking institutions; and No. 2, high CRA examination ratings are too commonplace.

I agree that these deficiencies should be corrected.

Today I am delighted that we have two panels of witnesses representing groups that have always been in the forefront of the consumer protection movement. These groups and these witnesses personally have made it their business to ensure public policymakers do not lose sight of the needs of the middle class and less affluent classes in our society. I salute them for their efforts in making ours a more humane society and look forward to hearing their testimony.

Senator Garn?

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Today we continue hearings on the consumer provisions of the banking bill passed by the House Banking Committee. I have made my views plain to everyone yesterday. But for those who were not there, let me briefly repeat myself. The Federal Government should not be in the business of allocating credit, which is exactly what these provisions would do. I will vigorously oppose the inclusion of any CRA provisions in the final banking bill that look anything like the CRA provisions in the House bill.

I agree with you, Mr. Chairman, there are some amendments that can be made. The House of Representatives has simply gone far too far.

Finally, let me also repeat something else I said yesterday. If I have anything to say about it, there will be no separate consumer bill this year if an overall banking bill is not passed. No home equity bill, no truth-in-savings bill, no credit-card bill.

So, if supporters who back these provisions want to see them enacted, they had better be prepared to push for passage of an entire banking bill.

You and I have put in a lot of time, Mr. Chairman, over a long number of years, trying to get some meaningful banking reform. And we passed the bill overwhelmingly with your leadership, 94–2 in the Senate. The House continues to stall.

So, it seems to me that after that overwhelming result in the Senate, if we can't come up with a comprehensive banking bill, it should not be piecemeal and these provisions should not be taken out and passed separately. If we can pass them as part of an overall bill, fine. But I just want everyone to understand what my position is on breaking it up into pieces.

Thank you.

The CHAIRMAN. Thank you, Senator Garn.

Senator D'Amato?

Senator D'AMATO. Thank you, Mr. Chairman.

I simply ask permission to submit my remarks as if read in their entirety.

The CHAIRMAN. Without objection, so ordered.

OPENING STATEMENT OF SENATOR ALFONSE D'AMATO

Senator D'AMATO. Mr. Chairman, as you know I consider the Senate banking bill grievously flawed in its failure to properly balance between the interests of the banking industry and the safety and soundness of the banks themselves. However, I will not belabor that point; we have had that debate already.

Nevertheless, Mr. Chairman, many interests of the consumers of banking services have not been addressed by this committee in its banking bill. Therefore, I commend you for holding these hearings. It is indeed appropriate to ask what will be the impact of such a grand and, in my view, inappropriate restructuring of the financial services industry on the consumers of those services. Perhaps in our haste to accommodate those who manage America's banks and financial service corporations, we have forgotton that small depositors and individual consumers also have a large stake in the structure of the banking industry.

The degree to which banks are regulated reflects the fact that banking, at least since the Glass-Steagall Act, is an industry in which the public has a significant interest. Banking services are a basic necessity in this modern society, and the relationship of a bank to its customers and to its community are a proper subject of our scrutiny while we endeavor to restructure this vital industry. I look forward to the testimony of today's witness.

Thank you, Mr. Chairman.

The CHAIRMAN. We are delighted to have as our witnesses this morning Jonathan Brown and Mildred Brown—no relation, I guess. Jonathan Brown represents Bank Watch in Washington, D.C.

Mr. Brown, go right ahead, sir.

STATEMENT OF JONATHAN BROWN, BANKWATCH, WASHINGTON, DC

Mr. BROWN. Thank you, Mr. Chairman.

Three panelists here have submitted a joint written statement, which I hope will be included in the record.

The CHAIRMAN. It will be included in full in the record.

Mr. BROWN. I would like to thank you for these hearings and the opportunity to testify. I would like to comment first that I was a witness at your 1977 hearings which led to the CRA legislation. So, we have had a very long interest in the Community Reinvestment Act.

From our perspective, looking at the broad menu of consumer provisions in both the House and Senate bills, we feel that Community Reinvestment Act reform warrants top priority. This is because the Community Reinvestment Act, as a concept, provides a basic safety net for the banking system to assure that it continues to serve local community credit needs and continues to focus on the local community. In this sense, CRA is a landmark piece of legislation, and we believe it's time to strengthen it.

I think that CRA is landmark legislation in the same way that the Truth-in-Lending Act was when it established the basic concept of full and fair disclosure for the individual consumer.

Then CRA looked at the issue of credit access from the community's perspective.

I believe there are two reasons why it is appropriate to strengthen the Community Reinvestment Act.

STRENGTHENING THE CRA

The first reason was documented fairly well in the hearings which you held last March, your CRA oversight hearings. The witnesses there made a very strong case that generally speaking there is a lot more that banks could do to serve local community credit needs. Some banks have done well, others have done very poorly. But generally, on average, there seems to be a feeling that more should be done.

Now, the second reason which warrants strengthening CRA has to do with the underlying structural changes in the banking industry. We have seen over the last 7 or 8 years a number of structural changes tending to uproot banks from their traditional ties to the local community. The structural changes aren't necessarily bad, but they certainly are changing the manner in which banks operate.

I think probably the most important change was the phase-out of reg Q. That put a lot more pressure on banks to change the nature of the services they offer and to become much more aggressive in pricing them—to be much more cost-conscious.

This has to some extent made them more careful in terms of making resources available to the local community. If they can't receive the highest yield on these resources or if there are extensive administrative costs in dealing with, say, small businesses or with local housing developers, they tend to look elsewhere. From the banks' perspective time is money. And so they are much more chary of their time than they used to be.

Now, another structural change which concerns us is the movement toward merging of the banking sector and the capital markets. Obviously, this is highlighted by your proposal to repeal Glass-Steagall.

The concern here is that increasingly banks are only willing to make loans which they can readily sell in the secondary markets or which could be securitized. Those loans tend to be very standardized, if you will, cookie-cutter type loans.

The concern is that the more the banks are under pressure to shift their operations to that standardized type of lending, the less they will be inclined to work at the local level with all the diverse credit needs that are not easily standardized, where considerable time may have to be spent in counseling the loan applicant, or a lot of time may have to be spent in packaging the deal. That is the heart of community development, and I believe that to some extent that is threatened by much of the structural change occurring in the financial sector.

Now, quickly shifting to CRA as we see it and how we would like to reform it, I think it is useful to view CRA as having three components. First, there are the assessment factors, which the agencies laid out in their regulations; and we think they did a good job. We think they followed the intent of Congress.

I see the light has come on.

The **Chairman**. You have a minute left.

Mr. **Brown**. Second, there is the evaluation process by which the agencies evaluate a bank's performance and assign a rating to it. We feel there is a fundamental problem in the evaluation process: that the ratings assigned by the agencies lack legitimacy. We believe it is necessary to improve the methodology that the agencies use in assigning CRA ratings and that they need more information in order to do that.

Then finally, the last point is that I would urge the committee to take a strong position in favor of disclosure of the CRA examination report which the agencies prepare and which is, in a sense, their underlying evaluation of a bank's performance.

Thank you, Mr. Chairman.

The **Chairman**. Thank you very, very much, Mr. Brown.

Our next witness is Ms. Mildred Brown, president of the ACORN, of Washington.

STATEMENT OF MILDRED BROWN, PRESIDENT, ACORN, WASHINGTON, DC

Ms. M. **Brown**. Good morning, Senator Proxmire. My name is Mildred Brown. I am the national president of ACORN. We are the largest grass-roots organization in this country. I am sorry, I am a little nervous until I get started.

But we represent—I represent sitting here right now—over 75,000 low- and moderate-income families in this country. They sent me here today to ask you to not let the banking regulators get by as they have been so far, in not doing their job with the CRA.

Getting to a little bit of background about myself, I am from Philadelphia, PA. I am the first black woman, the first national president not to come out of Little Rock, AR.

We have a strong organization and we believe in everything that we do. I am just saying we are called professional antagonists, but whatever we are called, we intend to go out and do the job that needs to be done to represent the poor and working poor in this country. That is something we will never stop doing.

BANK REGULATORS ARE NOT ENFORCING THE LAW

I come here today to implore you to pass title IV of the House banking bill. The Community Reinvestment Act, which was created by you, Senator Proxmire, is not working, not as you intended it to work. The regulators are not enforcing the law as it was written. The banks are not funneling moneys back into our communities as the law is supposed to mandate.

Banks are doing very well these days, but the laws are not being enforced or obeyed. I was reading yesterday's Washington Post, dated September 8. All in all, we have heard that the banks are failing. Some banks have been failing, sure.

But banks have run up record profits in just 3 months of this year alone, they earned $10.5 billion. Now, how can anyone tell me and my people that some of that money could not be channeled back into our neighborhoods?

Our cities are deteriorating. There is no reason why some of those funds could not be used to shore up our cities. ACORN is out there. We are willing to do what we can with our membership, but there is no reason why we can't get loans.

Please excuse me. I am not usually this nervous.

Title IV contains a package of reforms which will achieve the objectives that I just mentioned.

As things stand now, it is left up to people like me to come here and talk to you. I work 40 hours a week. I have a full-time job. I have a family. I have grandchildren I help support. I don't have the time. I don't have the energy to do what is needed to be done to regulate the banks.

There are people that are being paid to do that job, who are not doing it. The regulators are supposed to make sure that the CRA is being enforced. And that is not being done.

I have also been active in my community with what little extra time I have. I do devote to ACORN and other community groups that work for social justice, as you say. I don't have the time for making sure the banks do provide essential services to me and my neighbors. That is somebody else's job.

This room was filled yesterday, I heard you mention, with people that appeared: the staff from the regulators, they have all the time there is. But if they spent that time working for the people that are paid to enforce the CRA, then they wouldn't have any complaints.

It is in our testimony, but I would just like to stress my feelings on five main points that we want included in title IV banking bill:

We want to reform the CRA rating system. As you found out, it's not working as currently set up and intended to be. We are requiring public disclosure of CRA ratings and CRA evaluations. We want you to tell the agencies to train special CRA examiners, and we want you to require the banks to have a better-than-average rating before going into their more profitable business ventures that they want to do. And we also want you to set up a community review board.

Earlier, Senator Proxmire, it was said that it would be too expensive to enforce title IV. But again, if we look over the record, the banks have the money to invest and do whatever else they want to, and I feel they do have the money to provide us with the sunshine, to shine the light on what they're doing.

And it is to all of our advantage. If they don't understand what it is that we need from them or what it is they should be doing, set up a review board. We will sit down and talk with them. Who better knows what's going on and what is needed in our neighborhoods but those who are there?

They don't know. A review board is a must, and it is not something that can't be done. The CRA has worked. In Philadelphia it has worked. I have sat in on two negotiations with banks. We came away from there with over $100 million, agreements with those two banks. We developed a relationship with the bankers, and they do intend and have been working with us. And for that, we are grateful to them.

This can be done in other cities also. There is no reason why it can't be done.

I am not projecting the person that I really intend to project. I stand firm on my feelings about CRA, and we will not be swayed by it. We will listen. We will work with whoever and wherever. But we do stand firmly with that, and we will not give up the fight for CRA.

The CHAIRMAN. Thank you, Ms. Brown.

Our next witness is Allen Fishbein, general counsel for the Center for Community Change.

Mr. Fishbein, go ahead, sir.

STATEMENT OF ALLEN FISHBEIN, GENERAL COUNSEL, CENTER FOR COMMUNITY CHANGE, WASHINGTON, DC

Mr. FISHBEIN. Thank you, Mr. Chairman, members of the committee.

My organization is a nonprofit organization that has had a longstanding interest in CRA. We work with low-income community groups around the country, advising them on community reinvestment strategies and helping them to improve their communities.

It is always an honor and a privilege to appear before this committee and before you, Chairman Proxmire. My task today I think is a simple one. It is to convince you of the need to enact the title IV provisions in H.R. 5094.

COMMUNITY BENEFITS PROVISIONS

In my brief remarks today what I would like to do is to focus on subtitle A, the community benefits provisions, and in particular on the amendments that are included in the subtitle to the Bank Holding Company Act and the Savings and Loan Holding Company Act. These provisions were the topic of quite a bit of discussion by yesterday's witnesses.

But first, Mr. Chairman, I am sure that you must have appreciated the irony yesterday's testimony. If nothing else, title IV has accomplished one purpose: In my 10 years following CRA, I have never heard the industry ever been as complimentary about the existing Community Reinvestment Act as they were yesterday in their testimony before this committee.

The committee needs to decide in determining whether the title IV CRA provisions are needed is whether it is willing to accept the banking regulators' depiction of conditions. According to them, everything is fine, they have everything under control, disinvestment is not a problem in our Nation's urban areas and most banks are doing a very good job in serving the needs of local communities.

The facts speak otherwise. Redlining remains a serious problem. Studies now completed from one end of this country to the other show a continuing. Pervasive and ever growing pattern of disinvestment in low- and moderate-income areas, slow-growth communities and predominantly minority communities.

There were a record number of CRA challenges to applications filed in the last several years. The Federal Reserve Board notes that in the past 3 years they have received more CRA protests than they received in the first 7 years that the act was in existence. And CRA enforcement by the regulators is clearly inadequate, as the testimony before the oversight hearings last March clearly pointed out.

Now, regarding the amendments to both the Bank Holding Company Act and the S&L Holding Company Act, I would like to make several basic points:

The first one is above the purpose of these amendments. Quite frankly, it is intended to establish the expansion process once again as a powerful incentive for banks to fulfill their responsibility under CRA. This is accomplished in two ways: One by extending CRA review to certain types of nonbanking expansions; and two, by imposing a higher standard for nonbanking activities and interstate banking acquisitions as well.

Point two, I think it is important for the committee to understand that the existing linkage between CRA and expansion activity in current law. From the outset, Chairman Proxmire, you and other members of the committee recognized that the examination process alone was an insufficient incentive for certain institutions to help meet community credit needs. For that reason, CRA was grafted onto the expansion application procedures that were in place at the time, which quite simply required banks to maintain a satisfactory CRA record or risk the consequences, either denial or conditional approval.

Unfortunately, as the history has shown, this procedure has been a paper tiger. Information presented in last March, indicated that only eight denials have occurred in more than 50,000 applications that have been processed.

I would like the committee to contrast the Federal regulatory agencies in action with that of the Michigan Financial Bureau. This is entailed in our written testimony. An application came before the Michigan Financial Bureau by Comerica to acquire a Texas bank. It was protested by the community groups, and under the interstate banking law in Michigan, the Banking Commissioner is required to take into account the Federal CRA record of that institution.

Now, as it turned out, that record under a recent Federal Reserve Board examination was less than satisfactory, and through a fluke the rating was published. Once was made public the world knew that this institution's CRA record was unsatisfactory. As a result, the application was not approved until Comerica came up with a very substantial community reinvestment plan, targeted to improvements in the communities in Detroit.

Now, contrast Michigan's action with the same Federal Reserve Board, which processed an application by Comerica just the year before. This was also protested, and the Fed chose to do absolutely nothing to improve the performance of that institution.

The commitment process demonstrated by Michigan is really the essence of what the bank holding company amendments are in title IV.

Second, we think that stronger incentives are needed. Originally, the expansion activity in the banking system was largely through branching. That has obviously changed. Branching is less valuable to the banking system than it once was, so it is important to extend the coverage of CRA to nonbanking activities which are perceived as being more lucrative to the industry.

Now, I want to just point out—I know I am closing my time here—so let me point out that the Senate in S. 1886, has already agreed to the principle of expanding CRA to nonbanking activities. This was adopted through a floor amendment. The title IV amendments include a provision to require a higher standard for certain institutions, large bank holding companies that are seeking to enter new areas such as nonbanking, securities underwriting, and interstate banking. I think we can all agree that there expansions may have serious consequences for how well they can serve the needs of local communities.

Thank you, Chairman Proxmire.

[The complete prepared statements of Mildred Brown, Jonathan Brown, and Allen J. Fishbein follow:]

TESTIMONY OF

Mildred Brown
President, Association of
Community Organizations for Reform Now
(ACORN)

Jonathan Brown
Director, Bankwatch

Allen J. Fishbein
General Counsel, Center for
Community Change

on

Title IV of HR 5094
Depository Institutions
Act of 1988

Before the

Committee on Banking, Housing & Urban Affairs
U.S. Senate

September 9, 1988

I. INTRODUCTION

In the next weeks, senior members of the Senate Banking Committee will sit down with colleagues from the House to reconcile differences between the two bodies' versions of an important bank deregulation bill.

Assuming floor approval in the House,the Senate will be asked to accept a multipart community and consumer protection title which we believe to be an essential and integral part of this legislation. We commend Senator Proxmire and other Members of the Committee for holding these hearings to more fully educate themselves on the consumer protection title. We appreciate the opportunity to testify at these hearings, and to amplify on our strong endorsement of the Title in these written remarks.

Although we will concentrate in our oral and written testimony on Subtitles, A, B, and D of Title IV of HR 5094 this in no way signals a lack of support for other subtitles. We firmly back, for instance, the provisions which would require all depository institutions to offer low cost checking accounts, and to cash government check for people who do not have accounts. We also believe that it is high time that Congress enact Truth in Saving and Home Equity provisions like those contained in Title IV.

We will focus on aspects of the Title relating to the Community Reinvestment Act, and notification of bank closings, because these are prominent concerns of the organizations we represent and assist, and to save the Committee's time -- the other subtitles are being ably discussed by another panel of witnesses today whose views we share.

II. NEED FOR LEGISLATION

Innercities, older, and slow growth communities are dying for lack of credit. Without credit for mortgages and housing rehabilitation, for community development and economic development, neighborhoods decay and jobs disappear.

Since 1980, the federal commitment to low income housing and neighborhood revitalization has vanished. People have had to look to the private sector for resources, and have quite naturally turned to banks and thrifts for credit to finance redevelopment.

Not coincidentally, also since 1980, Congress, the agencies and the courts have been deregulating the financial services industry. One way or another, restrictions have been lifted on how institutions are required and forbidden to do business.

This leaves financial institutions more sensitive to market forces, and leads to concentration within the industry.

So when low and moderate income communities came to need bank services the most, banks fell under increased pressure to cut costs and streamline their operations. In the eyes of many bankers, this required upscaling, focusing on service to large businesses and wealthy individuals. Banks developed products for these markets, trained their personnel in new specialties, bought sophisticated equipment to increase their efficiency, and opened offices convenient to the target audiences. One consequence of upscaling has been that banks now do a worse job of meeting the convenience and needs of low and moderate income people.

Congress is poised to proceed with another phase of bank deregulation, allowing subsidiaries of bank holding companies to involve themselves in type of business previously off limits. From where we stand, it seems almost certain that this will further degrade the access to and the quality of services for the lower end of the market -- unless Congress enacts strong countermeasures.

We believe the Title IV of HR 5094 is precisely such a countermeasure. It is not all that we would want, and the many organizations which have been involved in helping to develop the

Title have compromised repeatedly along the way to accommodate the concerns and complaints of the industry. But thanks to the unwavering commitment of Chairman St Germain and other Members of the House Banking Committee, we emerged from Committee with a title which has the potential to make a difference in the lives of low and moderate income people.

Under the leadership of Chairman Proxmire, the Community Reinvestment Act became law in 1977. This act creates a continuing and affirmative obligation for all federally insured depository institutions to help meet the credit needs of low and moderate income people in their service areas.

For a variety of reasons, this law has not been widely obeyed or strictly enforced. These reason include the change in climate in the banking industry which we have been discussing, and indifferent enforcement by federal banking regulatory agencies, as last March's oversight hearing before this committee revealed.

But this innovative legislation creates an opportunity for community organization to become directly involved in the regulatory process. Many organization have protested applications filed by depository institutions on the grounds that these institutions have failed to meet their statutory obligations under CRA. This has led to dozens of productive negotiations between banks and community groups which have resulted in billions of dollars in credit being made available through creative programs in low and moderate income neighborhoods.

Although we are firmly committed to protecting and promoting this process, CRA obligations must not become operationally reduced to what can be won by community groups through the challenge process. The law must be enforced on an ongoing basis by regulators. The CRA rating system must be made meaningful, and banks must be given a powerful incentive to improve their performance and maintain an exemplary CRA record.

Title IV of HR 5094 would accomplish these objectives, at a time when it is especially important that private financial resources be made available to low and moderate income neighborhoods, and at a time when increasingly concentrated and ambitious financial conglomerates are least likely to fulfill the letter and spirit of CRA obligations voluntarily.

Subtitle A is designed to improve the regulatory process. It employs four means to accomplish this goal: 1) imporving the quality of CRA evaluations and ratings; 2) providing for public disclosure of CRA ratings and their basis; 3) instituting an improved rating system; and 4) creating a higher community reinvestment standards for institutions seeking expanded powers.

II. AMENDMENTS TO THE COMMUNITY REINVESTMENT ACT OF 1977

A root cause of inadequate CRA implementation has been weakness in procedures used by the agencies to perform CRA evaluations and assign CRA ratings. Thus, the road to CRA reform necessarily lies in improving the quality of CRA examinations, strengthening the CRA rating system, and increasing agency accountability by greater public disclosure. To this end, Section 405 of HR 5094 contains a series of amendments to the Community Reinvestment Act of 1977 that are designed to strengthen the CRA examination, evaluation, and rating process.

A. CRA Exam Disclosure

Section 405 of Subtitle A directs the Federal regulatory agencies to prepare a written evaluation of the institution's CRA performance after completing each CRA exam. The evaluation may exclude confidential information, like the names of individuals. It should state the numerical rating given to the bank and the basis for this rating, and discuss the facts about the bank's performance under each of the CRA assessment factor. Agencies are directed to emphasize the bank's record of serving the housing credit needs of low and moderate income people, plus the credit needs of small businesses and small farms.

Public disclosure of rating and evaluations is a vital element in CRA reform. We urge you to include this provision in the final bill.

We agree with the House Banking Committee that disclosure "will lead to a better understanding by both the banks and the communities of what is expected under CRA.", and that it may promote the development of productive relationships between banks and community groups. The overall climate of bank-community relations could improve dramatically, eliminating "misunderstandings, controversy, and at time protests that might be avoided with the information available up front."

We further agree that disclosure will transform the process whereby community groups generate comments on bank applications; community groups need no longer round up information piecemeal, but can instead gradually develop a reasoned judgment of a bank's CRA performance based on a much more complete picture of bank activity, including the facts and carefully formulated evaluations supplied by specially trained examiners.

Disclosure will mitigate against the current practice of rating inflation. As last March's oversight hearings before this committee revealed, 97 to 99% of the banks examined currently receive high CRA ratings. For example, HR 5094 directs the agencies specifically to provide information about the institution's performance in meeting certain types of credit needs. If would be indefensible to describe vastly different lending patterns, and then to assign identical ratings.

An agency could subvert this requirement by developing form evaluations and simply filling in an institution's name. But this ploy would be obvious to everyone, especially a Congress which has explicitly mandated that the agencies, perform and disclose the results of serious CRA exams.

If lucrative privileges are tied to earning, or making a commitment to earn, a "good" or "excellent" CRA rating, bankers will be eager to learn why they earned a specific rating, and how a competitor managed to get a better grade.

A series of evaluations for one institution will give insiders and observers a profile of progress or decline in compliance with CRA. Close review of a number of CRA exam reports could provide inspiration to bankers, community groups, and local governments about ways in which institutions can more effectively help meet the credit needs of their communities. The reports can telegraph the details of successful programs and policies around the country for other institutions to emulate, and likewise can convey portraits of banks that fall below average. Combined, the success stories and the stories of failures will give bankers something they have been clamoring for: concrete information on what is expected of them in terms of CRA.

It does not, nor never has, made sense to conceal information about an institution's CRA exam. When no one but the regulators ever knows whether the regulators have done the hard work that does into a good CRA exam, it creates an open invitation to "punt" this requirement, to put one's energies elsewhere. Given the tensions which inevitably develop between bank officers and examiners as the regulators scrutinize bank records, it is attractive to have an area where everyone can count on getting and giving an easy "A." Disclosure of CRA evaluations and ratings could strip away these clubby, comfortable excuses for evading the law. In fact, it is hard to imagine how CRA reform could succeed without requiring disclosure. Sunshine is the only antidote to these self-serving vices that grow in the dark.

B. Existing CRA Examination, Evaluation, and Rating Procedures

CRA Assessment Factors. The existing CRA regulations identify certain types of loans and activities, termed CRA assessment factors, that are to be given particular attention in evaluating CRA performance. These enumerated assessment factors -

- with their focus on ascertainment of credit needs, affirmative marketing, non-discrimination, low and moderate income neighborhoods, housing loans, small business loans, small farm loans, local community development activities, local economic conditions, and size and financial condition of the institution -- constitute a core definition of community reinvestment that is properly focused and accurately follows the intent of Congress in enacting the Community Reinvestment Act of 1977. HR 5094 does not in any way change these existing CRA assessment factors. Moreover, the Committee Report on HR 5094 states that the current CRA assessment factors are to remain in place and to serve as a key component of the new CRA rating system.

CRA Exam. The agencies conduct CRA exams at institutions as part of their regularly scheduled consumer compliance exams. A CRA exam involves extensive on-site interviews with an institution's officials and review of the institution's documents, and in some cases interviews with outside contacts. Although the scope of CRA exams has fluctuated widely over time and varied significantly between agencies, the CRA exams currently conducted by OCC and the Federal Reserve Board entail considerable examination time. For example, data submitted by OCC to the Senate Banking Committee for the Committee's March 1988 CRA oversight hearings indicate the OCC CRA exams average 16.5 examiner man-days at national banks with over $10 billion in assets, 9 examiner man-day at national banks with assets between $1 billion and $10 billion, and 2.5 examiner man-days at the smallest national banks.

CRA Rating System. At the conclusion of the CRA exam the senior CRA examiner prepares a CRA exam report and assigns a CRA rating to the institution. The CRA exam report contains an open section, which is shown to the institution, and a confidential section, which is not disclosed to the institution. The open section is a narrative that analyses the institution's CRA performance. In a sample of CRA exam reports provided by the Federal Reserve Board to the CRA Committee of its Consumer Advisory Council in 1985, these narratives were three or four single-spaced pages in length. The closed section of the report lists the outside contacts interviewed by the CRA examiner and contains the CRA rating assigned to the institution. Bankers find the current agency practice of showing them their own CRA evaluation but not their CRA rating to be rather bizarre. Community organization and consumer groups view the agency refusal to make public the CRA evaluations and ratings as most objectionable.

The agencies have adopted a uniform CRA rating system to guide CRA examiners in assigning CRA ratings. The current uniform CRA rating system employs five CRA performance categories:

community credit needs and marketing; types of credit offered and extended; geographic distribution; discrimination or other illegal credit practices; and community development. A CRA examiner is instructed to rate an institution on each of the five performance categories using a 5-grade rating scale with the following ratings: #1-strong; #2-satisfactory; #3-less than satisfactory; #4-unsatisfactory; #5-substantially inadequate. The CRA examiner then assigns an overall CRA rating to the institution using the same 5-grade rating scale. The overall CRA rating is a composite of the institution's rating on each of the five CRA performance categories, and the CRA examiner has broad discretion in assigning more or less weight to each performance category rating in arriving at the composite rating.

C. Weaknesses in Current CRA Examination, Evaluation, and Rating Procedures

CRA Performance Data. A major weakness in the existing CRA examination process is the failure of CRA examiners to obtain systematic information on the key CRA performance factors. For institutions subject to the Home Mortgage Disclosure Act (HMDA), an institution's HMDA statement does provide systematic information on the dollar amount and location of the institution's residential mortgage loans. However, CRA examiners do not as a general rule obtain systematic information on a institution's CRA performance in the following key areas: small business loans or small farm loans; support for community development entities and projects; participation in special loan programs; and affirmative marketing activities. Without such information it is impossible for a CRA examiner to conduct a CRA evaluation and assign a CRA rating that has full legitimacy.

Another adverse consequence of inadequate CRA performance data collection is that the occasional CRA examiner who does made a conscientious effort to collect performance data for a particular institution does not have peer institution performance data to provide a frame of reference. More experienced CRA examiners indicated to the CRA Committee of the Consumer Advisory Council in 1985 that they make comparisons based on their extensive experiences in conducting CRA exams at many institutions, but this informal, memory-based, comparative methodology is very subjective and not available to less experienced CRA examiners.

In view of the extended time spent reviewing documents and interviewing officials during CRA exams -- 16.5 man-days in the case of the largest national banks -- CRA examiners should be able to collect systematic information on the key CRA performance factors. The underlying problem is that the agencies have not specified the necessary information and instructed CRA examiners to get it. The agencies do send a CRA questionnaire requesting very general information on CRA performance to an institution prior to its CRA exam; but, most responses are perfunctory and of limited value for CRA evaluation purposes. Developing a more comprehensive CRA questionnaire would be a useful approach, since most banks have much of the relevant CRA information in their computer systems and advance notice would give them time to retrieve it.

Ratings System. Equally as serious, the current CRA rating system, in particular the uniform rating guidelines and the rating scale, do not provide CRA examiners with a useful framework for rating institutions' CRA performance. The uniform CRA rating guidelines are poorly structured, at time inconsistent, and not properly focused.

The most important of the five CRA performance categories in the uniform rating guidelines, Type of Credit, is riddled with ambiguity. Under the guidelines a CRA examiner may assign a #3 (less than satisfactory) rating for this performance category if an institution is not offering "one or more types of credit listed in its CRA statement," a pitfall that only the most foolish institution would fall into. Yet, the guidelines also provide that a #3 rating may be assigned if an institution's share of CRA-type loans is "marginal or somewhat below average." Obviously, this far more expansive definition could include a substantial number of institutions. Given the paucity of #3 ratings, it is clear that CRA examiners have opted for the narrow, technical definition.

The ratings approach for a second important CRA performance category, Community Development, is even more flawed. A CRA examiner may assign a #2 (satisfactory) rating to an institution that has made no resource commitment to community development entities or programs, so long as the institution is "planning to undertake some specific activity ... within the next six month." Although such a liberal rating approach might have been appropriate during the first few years of CRA implementation, it is certainly inappropriate eleven years after the law's enactment.

A third important CRA performance category, Community Credit Needs and Marketing, is also weakened by an overly permissive rating method. In this case, an institution is to be given a #2 (satisfactory) rating even though its affirmative marketing and credit related program are "not ongoing or comprehensive."

Finally, two of the five CRA performance categories do not even address the extent to which an institution is commiting resources to CRA activities, i.e., affirmatively serving its local community's credit needs. One of these non-germane categories relates to the institution's compliance with consumer credit laws, including fair lending regulations. The other relates to discriminatory lending practices which although "unreasonable" may not in a technical sense constitute a violation of fair lending regulations. Without question, the agencies should use CRA to bolster their fair lending authority and determine discriminatory lending practices where fair lending violations may be difficult to establish for technical reasons. However, the fact that an institution has not engaged in consumer credit violations or "unreasonable" credit discrimination should not serve as a measure of the extent to which it is committing resources to CRA activities. The appropriate approach would be to rate an institution's CRA performance without these two performance categories, and then where violations or discrimination exist, lower the initial CRA rating.

Taken as a whole, the agency rating guidelines can leave a CRA examiner with the impression that it is appropriate to assign a #2 (satisfactory) rating to an institution that has avoided discriminatory practices, honored its CRA Statement, and made some gestures toward establishing an affirmative marketing program and participating in a community development program. Given that the agencies have not articulated a policy of strong CRA implementation, it is not surprising that most CRA examiners have interpreted the guidelines in this fashion and that rating inflation has become widespread.

Moreover, the rating categories of the existing CRA rating scale (strong; satisfactory; less than satisfactory; unsatisfactory; substantially inadequate) are inappropriate) are inappropriate for CRA rating purposes. With three of the five rating categories representing varying degrees of unsatisfactory performance -- the approach used for traditional consumer compliance exams -- the rating scale has encourage CRA examiners to look for procedural compliance rather than to take seriously the job of assessing the extent to which an institution is committing resources to CRA activities.

Rating inflation is not the only adverse consequence of weakness in the CRA evaluation and rating system. More generally, CRA ratings are viewed as arbitrary and lacking legitimacy by many bankers as well as community organizations. Institutions have become frustrated because they have not been given consistent signals as to what is expected of them in the way of CRA performance. Moreover, from an institution's perspective, lack of legitimacy to CRA evaluations and rating complicates the application process. A protested application takes more time to process when the applicant's CRA evaluation and rating (previously prepared by an agency during its regular CRA exam) carries little weight and a more adequate record of the institution's CRA performance must be constructed practically from scratch while the application is pending.

D. Reform of CRA Evaluation and Rating Procedures

Systematic Information on CRA Performance. Section 405 of the House bill directs the agencies to jointly develop a CRA examination format to be used by CRA examiners during CRA exams to collect data on an institution's CRA performance. This CRA examination format would vary for different size categories of institution and between commercial banks and thrift institutions. For institutions with assets of $100 million or more, the CRA examination format would minimally include performance data on the following factors: housing loans in low and moderate income neighborhoods or equivalent areas; small business and small farm loans; support for community development entities or projects; participation in special loan programs; and affirmative marketing activities.

Rating System. Section 405 of the House bill would establish a CRA rating system that would give more useful guidance to CRA examiners and serve as a more effective CRA encouragement tool. The bill makes clear that the underlying goal of the CRA rating process is to measure the extent to which an institution is committing financial and managerial resource to CRA activities. The bill states explicitly that CRA ratings should be made on a comparative basis with institutions of comparable resources serving as the peer group. The agencies are directed to adopt CRA rating guidelines based on these premises. Revision of the rating system along these lines should eliminate much of the ambiguity and confusion that permeates the current system.

The House bill also directs the agencies to adopt a new 5-grade CRA rating scale with the following rating categories: #1-excellent; #2-good; #3-average; #4-limited effort; and #5-poor or substantial noncompliance. This new rating scale would provide a far more useful yardstick for measuring an institution's level of resource commitment to CRA activities than the current rating scale. In view of the weakness to date in agency CRA implementation, neither the agencies nor Congress have enough information on CRA performance patterns within the banking industry to set an objective definition of "satisfactory" CRA performance. Thus, the House bill wisely anchors the new rating scale by defining a #3 rating as "average," the CRA performance level prevalent within the banking industry. This practical approach is entirely consistent with the underlying comparative rating methodology. Moveover, by defining a #3 rating as "average," the new rating scale will tend to discourage the agencies from automatically assigning #3 ratings to almost all institutions -- the current pattern of CRA rating escalation.

The House bill establishes a #2 (good) CRA rating as the standard for institutions engaged in expansion via interstate banking or non-banking activities. This means that such institutions will have to raise their CRA performance above the level currently prevailing within the banking industry. The need for such improvement was shown dramatically in the Senate's Banking Committee's recent hearings on CRA implementation.

It is important to bear in mind that the new CRA rating guidelines envisioned by the House bill will not consist of a set of ratios and numeric formula that will enable a CRA examiner to mechanically compute an institution's CRA rating. Rather, the guidelines should give a general description of the different grades in the rating scale -- e.g., what "good" means in general terms. The guidelines should also address key policy questions, such as how to rate an institution that has specialized in one lending activity, or how to select peer group institutions.

Even under the new rating system the assignment of a CRA rating will still ultimately depend on the exercise of judgment by the CRA performance However, the more systematic information on CRA performance and the improved rating methodology will make this decision easier for the CRA examiner.

Moreover, it is unrealistic to think that the new CRA rating guidelines will lay out performance standards that prescribe a clear CRA performance pattern for each rating grade. It is only by reviewing individual CRA exam reports and seeing how the agencies have applied the rating guideline to the fact patterns of individual institutions' performance that bankers or the public will be able to gain a sense of the underlying agency CRA standards. For this reason, as well as for the more general goal of agency accountability, the provision in the House bill requiring the agencies to publicly disclose CRA examination reports is essential.

IV. AMENDMENTS TO THE BANK HOLDING COMPANY ACT

Section 403 of the House Banking Committee bill amends the Bank Holding Company Act by establishing new "community benefits" requirements for certain types of expansion activities by bank holding companies. Section 404 applies community benefits requirements similar to those in Section 403 to S&L holding companies. We urge the Senate conferees to adopt these provisions, along with the other much needed reforms addressed in Subtitle A.

Sections 403 and 404 are premised on the view that reforming the Community Reinvestment Act rating and evaluation system alone will not provide a sufficient incentive for many banking institutions to fulfill their statutory responsibility to help meet the credit needs of their communities, including low and moderate income neighborhoods. Consequently, these amendments are directed at improving the linkage between CRA and certain bank expansion activity. These sections also contain new safeguards to help ensure that the expansion by banks into the securities field and other new fields does not reduce access to essential banking services for modest income consumers and neighborhoods.

A. Existing CRA Procedures

CRA is a restatement of long-standing law, requiring banking institutions to demonstrate that their facilities serve the "convenience and needs" of the communities in which they are chartered to do business. The act specifically finds that convenience and needs means the need for credit services as well as deposit services and it directs the banking regulatory agencies to use their supervisory authority to encourage banks to help meet the credit needs of their local communities.

In enacting CRA, Congress envisioned that the expansion approval process would be directly related to the community reinvestment performance of the applicant. Accordingly, CRA was grafted onto the existing application review and approval procedures for each of the agencies. Under the existing CRA regulations, the appropriate federal regulator must take an institution's community reinvestment record into account in its evaluation of any proposed expansion. Moreover, the agency may use an applicant's CRA record as the sole basis for denying an expansion request. In short, the regulatory approval process was intended to serve as an integral component of an agency's effort "to encourage such institutions to help meet the credit needs of the local communities in which they are chartered. . ." (12 U.S.C. Sec. 2901).

Similarly, Federal Reserve Board (Fed) regulations require the agency to consider the CRA records of each subsidiary bank of an applicant bank holding company as well as each subsidiary bank of the target institution, whenever such an institution seeks to expand under section 3 of the Bank Holding Company Act. 12 C.F.R. Sec. 229.8. Comparable regulations exist for savings and loan holding companies. Here again, these procedures are intended to provide an incentive to encourage bank and S&L holding companies to be responsive to the credit needs of their entire lending areas or risk the consequences (e.g. denial or delay of their proposed expansion).

Unfortunately, the original intent of Congress has been stymied by the continuing reluctance of the regulatory agencies to utilize this clout. As you know, testimony at the March CRA oversight hearings revealed that of the more than 50,000 expansions processed by the federal regulatory agencies since CRA was enacted, a mere 8 were denied on CRA grounds.

No agency has been more adverse to using the regulatory approval process as a means for improving bank performance than the Federal Reserve Board. The Fed is the only agency which has yet to deny an application on CRA grounds. In fact, as Governor Seger conceded in her testimony at the oversight hearings, the Fed will not deny applications for CRA reasons, regardless of the weakness of an applicant's or the target institution's record.

The Fed maintains that obtaining commitments for improved performance from an applicant is preferable to outright denial of an application. Yet, in the relatively few cases in which the agency has obtained commitments, the Fed rarely has required institutions to develop substantive plans for improving their community reinvestment performance. Nor is there evidence to suggest that the agency ever monitors whether even these minimal commitments have been met.

The failure by the Fed and its sister agencies to utilize the application process to encourage improved community reinvestment performance has succeeded in turning CRA into a "toothless tiger." This is a point acknowledged by community leaders and bankers alike.

In stark contrast with the Fed's ineffectual approach, the Michigan Financial Bureau recently demonstrated how tough enforcement of CRA standards can produce meaningful results. In July, the Bureau's Commissioner refused to approve a merger application by Comerica, Inc., one of the state's largest financial institutions, until such time as the bank holding company agreed to develop an adequate targeted plan for improving its reinvestment performance in Detroit. Interestingly, the Commissioner's decision was based largely on a Federal Reserve Board examination indicating inadequacies in the bank's CRA record.

Mind you, last year the Fed had a similar opportunity to use the application process to press Comerica to improve its CRA performance. Although a well-documented challenge to the bank's deficient lending record was brought by Detroit community groups, the Fed chose to do absolutely nothing. The expansion was approved without any commitments.

In response to the Michigan banking Commissioner's tough stand, late last month Comerica submitted a comprehensive lending plan, in which the institution committed to lend $280 million for housing, small business, and commercial loans, by 1990. This commitment represents a 100% increase in the bank's lending to Detroit. The plan, which includes more than 60 new community reinvestment initiatives, was developed after extensive consultation with the city's community, business, and government leaders about underserved community credit needs.

The State of Michigan's action on the Comerica application demonstrates that the application review process can be a very effective tool for encouraging improvements in the CRA activities of applicant institutions. The Comerica plan far exceeds any community reinvestment commitments obtained, or conditions imposed by the Fed for any institution, including those with poor CRA exams. Michigan's action is something the Fed could have done itself, but which it has consistently refused to do.

However, in order to charge the current system, the Fed will need more than a nudge, it needs a kick in the pants. HR 5084 provides such a boot.

B. Community Benefits Requirements in HR 5094

The Community Benefits Requirements contained in Sections 403 and 404 are intended, pure and simple, to put teeth in CRA.

The key provision requires bank (and S&L) holding companies to possess an above average CRA performance as a prerequisite for expanding into certain non-banking fields or merging with or acquiring other institutions across state lines. Specifically, the Federal Reserve Board can not approve these types of expansions unless the bank holding company possesses an "excellent" (1) or "good" (2) CRA rating.

At the same time, however, the provision does not prevent an institution with an "average" CRA performance, in other words an institution whose practices reflect prevailing industry practices, from also receiving permission to expand providing it has made commitments to improve its CRA performance within two years. Thus, an institution could quickly become eligible by developing the type of plan Comerica submitted to the Michigan banking agency.

In addition, the community benefit requirements put additional teeth into CRA, by establishing that holding companies with substandard CRA records (i.e. "4" or "5" CRA rating) are ineligible to engage in interstate expansions and acquisitions into non-banking activities, at least until such time as they bring their CRA record up to at least prevailing industry practices (i.e. a "3" CRA rating). Such a requirement would serve notice to the banking industry that Congress is serious about requiring the "rotten apples" to fulfill their obligations to their local communities.

Although we believe that this new incentive system would mesh effectively with revised CRA evaluation process, the new requirements do not mandate failure, or limit eligibility through any mathematical formula or "bell-shaped" curve. As the House Banking Committee report noted, it is entirely conceivable that a relatively high percentage of institutions would rise to the 1 and 2 rating levels, under an industry improvement in CRA performance.

Again, the community benefits requirements mandated in HR 5094 are intended to make the existing CRA incentive system work. The difference is, whereas now agencies like the Fed can conveniently ignore CRA in expansion approvals whenever they choose, the revised system requires them to use the community reinvestment records of bank (and S&L) holding companies for future regulatory expansions.

The higher CRA standard set out in Subtitle A applies to only three types of expansions by bank holding companies: 1) interstate acquisition and mergers; 2) certain non-banking activities currently permitted under Section 4(c)(8) of the Bank Holding Company Act; and, 3) new non-banking activities authorized by the pending legislation. Admittedly, these represent important types of new activities for the banking industry and with the exception of category 1, activities not currently covered by CRA.

It is essential for the Committee to recognize that unless important expansion activities are covered by these provisions, banking institutions may have too little incentive to continue to fulfill their lending responsibilities to many communities.

When CRA was enacted back in 1977, Congress anticipated that the regulatory approval process covering branch applications, and other depository institution expansions would provide a sufficiently valuable incentive for financial institutions to fulfill their community reinvestment responsibilities. However, changing conditions in banking have made the traditional deposit service expansion less valuable to many banks. At the same time, these changes have steadily increased the importance of new types of expansions, often involving the acquisitions of non-banking affiliates. Adopting the requirements set out in

Section 403 and 404 restores a meaningful incentive system, which is perfectly consistent with the original thrust of CRA. Without these important adjustments, we fear that the commitment of banks to older urban communities and slow growth rural areas will deteriorate.

In fact, the Senate already has recognized the principle of broadening the types of expansion activity covered by CRA. As a result of a floor amendment, S. 1886 contains a provision similar to HR 5094 bringing the same types of non-banking expansions under CRA review. However, the Senate provision does not reform the current and inadequate CRA system, an important difference from HR 5094. Moreover, the Senate bill does not require institutions to meet a higher community benefits standard like the one contained in the House bill.

C. The Need For Higher CRA Standards

The community benefits requirements apply a higher CRA standard for the three types of expansions specified in HR 5094. The normal CRA standard requiring the agency to take an institution's CRA record into account would apply for all other types of expansions.

We believe requiring institutions to possess an above average community reinvestment record in order to engage in interstate banking or to engage in certain non-banking activities is justified.

First, interstate expansions are accelerating the growth of regional and national mega-financial institutions. Whatever benefits may be associated with this increasing consolidation, interstate banking threatens to detach banks from their local community base. The tougher standard is needed to help ensure that interstate banking does not also accelerate disinvestment in certain communities. Limiting eligibility to institutions with an above average community reinvestment record would help ensure that these larger banks are fulfilling their traditional banking responsibilities to their existing local communities. Moreover, interstate banking will lead to a more concentrated financial system and it is, therefore, appropriate to hold institutions wielding greater economic and political power to higher reinvestment standards.

Similarly, the existing non-banking activities which holding companies are permitted to engage in, such as mortgage banking, are in some cases another form of interstate activity. Consequently, the stronger community reinvestment standard is appropriate here as well and should provide an added inducement for these institutions not to abandon their local communities' needs.

Lastly, entry into securities activities should be limited to those institutions with strong CRA records. Mixing banking with securities will result in the growth of increasingly concentrated mega-financial institutions. These financial giants are capable of exercising much greater market power and other influences over consumers. It is entirely appropriate for Congress to ensure that these financial giants have above average community reinvestment records as they are permitted to expand dramatically into new fields.

D. Pattern of Activity Requirements

In addition to requiring above average CRA records, the new community benefits provisions include two new standards which are designed to guard against certain adverse effects resulting from bank expansion into new activities and areas. These new standards are intended to ensure that bank holding companies do not unfairly or arbitrarily discriminate against low and moderate income areas when making decisions to acquire or charter a bank, or open or close a branch facility. Bank holding companies also are required to promise that their engagement in securities activities will not lead to the reduction of financial services to low and moderate income consumers and neighborhoods.

The two new anti-discrimination standards are needed in view of the proliferation of aggressive new banks, both full-service and "non-bank banks" that have come into operation, with the avowed purpose of seeking to cream affluent markets. These "boutique banks", as they are sometimes known, carefully avoid establishing a physical presence in older urban neighborhoods and other more modest income communities, while competing for deposits and other business with the older institutions. While the competition may be advantageous to some bank customers, it also increases the pressures on older banks with much broader service areas to curtail their services to inner-city areas, which bankers may view as less lucrative markets.

While new in some respects, it should be emphasized that these two new anti-discrimination standards are an extension of existing CRA requirements for federally chartered and insured banks. Under CRA, banks are required to publish a map delineating their community lending area. Federal bank examiners review these delineations to determine whether they have been gerrymandered to exclude low and moderate income areas. If the delineated community appears to have been gerrymandered, the regulator may direct the bank to include the neglected areas within its lending area.

The CRA regulations do not, however, permit the examiners to comment in a similar manner on the distribution of an institution's facilities. The new anti-discrimination requirement would permit the agencies to do so, and authorize the Fed not to approve applications by bank holding companies that appear to be engaged in clear patterns of gerrymandering.

The new community benefits standard is also needed to discourage banking institutions from closing branches or selling off banks in low and moderate income areas in an effort to avoid fulfilling the basic banking and government check cashing requirements set out in Title IV of the House Banking Committee's bill. In addition to these tests, we believe that it is essential that the deposit services requirements be implemented in a way that minimizes any adverse impact on the future location and availability of deposit taking facilities that serve low income areas.

Although intended to curb the wholesale avoidance of certain geographic areas, the anti-discrimination provisions in HR 5094 does not preclude an institution from gaining approval for any expansion activity covered by the bill. If the Fed determines that the institution has engaged in a clear pattern of gerrymandering, it may reconsider its finding upon a submission of a plan by the bank holding company to improve its servicing to the excluded communities. The provision also contains an escape clause for bank branch closings which may have occurred for safety and soundness reasons. These provisions help to ensure that the new community reinvestment tests will not impose unduly harsh or inequitable burdens on suburban banks or institutions located primarily in low and moderate income areas.

E. Preliminary Approvals

Perhaps one of the least understood provisions in the community benefits title is the one permitting bank holding companies with average CRA records to receive "preliminary" approval of certain expansions. Some claim that the new procedure will substantially delay regulatory approvals. This need not be the case. In fact, the preliminary approval process is designed to permit those institutions without above average CRA records to go forward with their acquisitions.

Under the proposed system, an average rated bank holding company could receive preliminary approval, providing the it was willing to take steps to improve its performance over a two year period. Six-months after preliminary approval was granted the Fed would review the extent to which the institution had begun to implement the commitments it had made to the Fed.

The six-month provision was inserted to provide additional guidance to the institution about whether or not it was on track in meeting its two-year goals. The preliminary approval procedure should not significantly delay approvals. While failure of the institution to meet its commitments could result in civil penalties, the likelihood of such sanctions would be minimal, assuming the institution had made a good faith effort to meet its original commitments.

For example, had the Comerica application come before the Fed under the new community benefits provisions, preliminary approval of the acquisition could have been granted, contingent upon satisfactory submission of a community reinvestment plan. Comerica was able to develop such a plan and resubmit its application to the Michigan Financial Bureau within one month after the initial regulatory action was taken. We would anticipate that institutions with average CRA records could receive preliminary approval in a similar fashion.

F. Imputed Rating

The Community Benefits section contains procedures for determining a bank holding company's CRA rating for the purposes of the approval process. Under this procedure the overall rating a holding company receives will be determined by the CRA ratings for each of its banking subsidiaries. For a multi-bank holding company, the lowest CRA rating of any of its subsidiaries will determine the "imputed" rating the institution receives.

The imputed rating system accomplishes several objectives: it provides an incentive for a holding company to improve the lending performances of each of its subsidiaries; second, it prevents banks with poor CRA records from hiding behind the records of other subsidiary banks.

The imputed rating system closely parallels existing CRA procedures, which require the Fed to consider the CRA record of each of a bank holding company's subsidiaries whenever it seeks regulatory approval to expand. The difference is that the existing procedure is permissive, rather than mandatory. In order words, under the existing system the Fed is not bound to seek improvements in performance, even if a subsidiary bank has a substandard CRA record. Under the new provision, the Fed could not permit approvals unless each subsidiary bank had at least an average reinvestment record.

The House Banking Committee bill includes a number of variations on the imputed rating system for some multi-bank holding companies. Intrastate bank holding companies with more than five subsidiary banks may have an imputed rating one grade above that of the lowest 20 per cent of subsidiary banks in the state. This variation was adopted by the Committee to help ensure that certain bank holding companies were not penalized due to restrictive branching laws in certain states.

Similarly, the Committee adopted an amendment at mark-up which permits bank holding companies with more than five banking subsidiaries in other states to have an imputed rating one grade above its lowest graded subsidiaries providing those subsidiaries do not constitute more than 7.5% of the assets of the holding company.

The variations for multi-state bank holding companies owning banks outside of a state create loopholes which could permit bank holding companies to exclude for imputed rating purposes relatively large bank subsidiaries. Rather than permitting such loopholes, we favor a provision that would cap the maximum size of an institution that could be exempted. This additional cap prevents, certain large banks from receiving favorable treatment from the imputed rating requirement, while ensuring that multi-bank holding companies with many small bank subsidiaries would not be placed at any serious disadvantage.

G. Additional Exemptions From Imputed Rating System

In addition to the above mentioned variations on the imputed rating system for certain multi-family bank holding companies, HR 5094 exempts several other categories of banks from the imputed rating system. These exemptions are as follows: newly established banks; banks with assets under $25 million in assets all agricultural banks under $50 million in assets; and, institutions acquired under emergency procedures and containing safety and soundness ratings of 4 or 5.

Exempting banks with a CAMEL rating of 4 or 5 from the imputed rating system was adopted by the House Banking Committee to avoid situations in which a potential acquiring bank may be deterred from purchasing a distressed institution because of a weak CRA record. Yet, some have maintained that by exempting a distressed institution from the imputed rating system would have the unintended effect of publicizing the condition of these institutions. However, should the committee believe this concern needs to be addressed in the legislation, criteria other than the CAMEL rating can be used to determining whether an institution is exempted from the imputed rating system. For example, information concerning an institution's current net worth and which is publicly available through the Statement of Condition Report could serve as the basis for exempting certain institutions from the imputed rating system.

H. Applications Review Procedures

The revised application review procedures are intended to address complaints raised by community groups and bankers about the adequacy of existing procedures.

In testimony last March before this Committee, a number of local and national organizations complained of how the Fed was arbitrary in acting on requests by community groups to extend the existing public comment period. The groups also reported that the existing period was often inadequate, since notice on pending applications were not received from the Fed until close to, and in some cases, after the 30 day period had expired.

Subtitle A codifies much of the existing expansion procedures under current regulation. However, it also addresses major concerns voiced by community groups and by bankers regarding how CRA issued are resolved. Community groups complain that the current up-to-30-day public comment period is inadequate. Notice of pending application is frequently mailed well after the start of the 30 day period. As a result, citizens' are not afforded adequate opportunity to make informed comments. Requests for extensions are handled arbitrarily and inconsistently.

The new procedures provide for a slightly longer public comment period. Perhaps more importantly, the period cannot begin to run until after the Fed has published notice of the pending expansion. This is intended to help ensure that community groups receive the full 45 day period to develop and submit their comments.

At the same time, HR 5094 addresses the complaint often heard from bankers, that CRA protested applications are unnecessarily delayed by regulators regardless of the institution's community reinvestment performance or the relative merits of the written protest. Subtitle A imposes expedited procedures on all applications subject to CRA. Thus, non-protested expansions must be acted on within 60 days after notice is published, posted and distributed to the public. Expansions in which substantial public comments have been filed, must be acted on within an additional 30 days. In other words, financial institutions are assured of having all CRA issues resolved within specified periods of time, unlike current procedures.

In fact, we believe the expedited review procedures go too far, imposing a unnecessary burden on the regulatory agencies to resolve all CRA issues within 45 days of the close of the comment period. This may be a particularly difficult deadline to meet in cases in which the regulator has held a public meeting on the pending expansion. We favor allowing the Fed to use discretion to extend the review period an additional 30 days, beyond the 90 day period should it determine the issues presented by the CRA protest warrant this extended review.

We believe that these reforms are essential to improving CRA enforcement. They reflect compromise and a sincere desire to balance legitimate industry concerns against the needs of modest income consumers and neighborhoods.

V. BRANCH CLOSINGS

Bank branch offices in low and moderate income neighborhoods have been slamming shut at an alarming rate for the past several years as banks try to cut costs and streamline their operations. Every indication is that this trend will continue and accelerate.

Chase Manhattan Bank, for example, shut 49 branches, more than 20% of it's branches, in the metropolitan New York area this year. The series on redlining published by the Detroit Free Press last month reported that 48% more of the full service branch offices in Detroit lie within a two mile radius of the city's white areas than within a two-mile radius of the black neighborhoods. A study of 50,000 commercial bank branches throughout the United States concluded last year that half of these branches were losing money, increasing the chance that they will be closed. New branches that have been opening have almost all been in prosperous areas.

The disappearance of bank branches in poor neighborhoods makes it more difficult for residents to apply for loans, obtain change, cash checks and put their valuable in safe-deposit boxes. The Committee Report notes, "The lack of a nearby bank branch is particularly hard on senior citizens and mothers with children and other who find if difficult to travel distances to carry out simple banking transactions, not to mention the cost of transportation. Small businesses often are hampered by the lack of deposit facilities in the neighborhood. (at 133)

The elimination of branches may also make it less likely that low income people and minorities will get their loan application approved, once they make their way to a functioning office. Loan officers in branches can be expected to be familiar with the neighborhood and to have a better basis for assessing an applicant's creditworthiness. The stereotypes that contributes to redlining are easier to form about people who live in distant and quite different neighborhoods.

Subtitle D of Title IV would provide a modest palliative for the serious problem of wholesale branch office closing in low and moderate income neighborhoods. It requires nationally chartered banks and thrifts to notify regulators and customers of their intentions to close a branch at least 90 days before the branch is shut down. If an individual or organization registers a significant objection to the proposed closing, the bank or thrift must explain in detail the reason for shutting down the facility and provide certain information about the branch's activities. The regulator must determine whether the branch closing would result in a significant reduction of services in the area, and if it would, the regulator must explore with community leaders and financial institutions the possibility of creating other sources of bank services.

We stress that in no case does Subtitle D empower a regulator to prevent a bank or thrift from closing a branch. It requires at most only three months of notice, and in special cases, it requires banks to supply regulators with some easily obtainable information. Further, the subtitle spells out that an exception is to be made to the notice requirement for institutions which are being place in receivership, or are the object of an emergency acquisition.

We encourage this committee to take up independently the problem of bank branch closings in low and moderate income neighborhoods. The disappearance of bank branches is both a cause and a symptom of a community's decline, and the loss of this resource erodes the quality of life of the people who could have been served by the branch. Representatives of all groups involved in and affected by this trend -- community leaders, small businesspeople, regulators and bankers -- should be brought together by the Senate Banking Committee to confront the problem head on and to begin to generate solutions.

In the meantime, the branch closing notification provision should be included in whatever bank modernization bill becomes law. Notification will provide communities with the opportunity to consider ways to fill the gap which will be left by the branch. Negative responses to the notice by customers can alert large, multi-branch banks to the fact that closing a given branch will create an exceptional hardship, and give them the opportunity to rethink their overall branching strategy.

This concludes our formal written testimony. We would be glad to answer your questions.

VI. AGENCY REFORM: A SEPARATE DIVISION OF CONSUMER AFFAIRS

Section 411 of H.R. 5094 would direct the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Federal Home Loan Bank Board (FHLBB) to establish separate consumer divisions no later than January 1, 1991. The consumer division at each agency would be responsible for conducting consumer compliance (including CRA) exams, developing procedures for consumer exams, supervising and training consumer examiners, undertaking supervisory action relating to consumer protection and community reinvestment laws, developing proposed regulations in regard to consumer protection and community reinvestment laws, and making policy recommendations in the consumer protection and community reinvestment area.

Section 411 would also require that consumer exams be conducted by examiners who are specialists in consumer (including CRA) compliance. In addition, this section would direct the OCC, FRB, FDIC, and the FHLBB to conduct a consumer (including CRA) exam at each institution no less frequently than once every two years.

The reforms contained in Section 411 are essential to strengthening CRA implementation and achieving full compliance with the equal credit opportunity laws and consumer protection laws that apply to banking institutions.

A. A Separate and Fully Integrated Division of Consumer Affairs

Full-fledged divisions of consumer affairs would parallel the existing divisions of examination and supervision, which have a predominant focus on safety and soundness and view consumer compliance as peripheral. Establishing a separate, full-fledged division of consumer affairs in each of the federal banking agencies is the best way to foster leadership with a strong sense of mission in the consumer area. However, establishing a separate division of consumer affairs will be only a cosmetic reform unless the division is placed in charge of consumer examinations and enforcement.

As we interpret Section 411 of the House bill, the concept of a separate structure and separate chain of command for consumer affairs would extend to the regional operations of the federal banking agencies, i.e., the 12 Federal Reserve Banks, the 12 Federal Home Loan Banks, the 6 OCC District Offices, and the 9 FDIC Regional Offices. Each regional unit should have a director of consumer affairs who reports directly to the division of consumer affairs at the federal level. A regional director of consumer affairs would be in charge of all consumer examinations, supervisory responses in the consumer area, consumer complaint procedures, and other consumer related activities conducted by his or her regional unit.

The FRB is the only federal banking agency that has established a full-fledged division of consumer affairs. The FRB's Division of Consumer and Community Affairs has responsibility for developing consumer examination procedures, drafting consumer regulations for consideration by the board, and monitoring consumer complaint handling. The FRB's Division of Consumer and Community Affairs also performs the important function of reviewing the consumer enforcement activities of the Federal Reserve Banks, which under the Federal Reserve System are directly responsible for consumer exams, consumer supervisory actions, and consumer examiner hiring. The Division conducts an annual audit of all the consumer compliance activities of the Federal Reserve Banks to ensure that FRB policies are being followed.

Yet, the FRB's Division of Consumer and Community Affairs does not exercise direct administrative control over consumer exams and consumer examiners, as required by Section 411 of the House bill. In the Federal Reserve System, consumer examiners, like all other examiners are hired, supervised, and promoted by the Federal Reserve Banks. Within each Federal Reserve Bank the consumer examiners operate within an all-purpose division of supervision and regulation, rather than from a separate consumer division. Notwithstanding the underlying authority of the FRB's Division of Consumer and Community Affairs to set policy in the consumer compliance area, the individual Federal Reserve Banks exercise important discretion in consumer enforcement and there are significant variations in practices among them.

At the OCC, consumer examination and supervision activities are lodged within a general Operations Division which has a primary focus on safety and soundness concerns. The OCC has a separate consumer policy unit within a general Policy Division. The consumer policy unit is responsible for developing examination procedures, drafting consumer regulations, and monitoring the handling of consumer complaints. Each of the 6 OCC District Offices has an organizational structure parallel to that of OCC's Washington office.

At the FDIC, control over consumer examination activity, including the development of examination procedures, is lodged within a general division of bank supervision. The FDIC has a separate Office of Consumer Affairs that reports directly to the Chairman, but this office has little direct responsibility in regard to consumer examinations.

The FHLBB has assigned virtually all of its examination and supervision functions to an office outside the agency that is funded by the Federal Home Loan Banks. This office is known as the Office of Regulatory Policy, Oversight, and Supervision (ORPOS). Within ORPOS there is virtually no oversight of consumer enforcement activity. Written procedures for consumer examination activities are out-of-date and there is little review of consumer examination activity. All examiners in the FHLBB system are hired, supervised, and promoted by the Federal Home Loan Banks.

B. Specialized Consumer Examiners with Separate Career Paths in Consumer Compliance.

Section 411 of the House bill would require consumer exams to be conducted by examiners who specialize in consumer law and work full time on consumer compliance. These examiners would be recruited, trained, and promoted as consumer examiners, as distinct from safety and soundness examiners.

The alternative approach is to rely on "all purpose" examiners who are trained to cover all examination areas, including safety and soundness and consumer compliance. The drawback with this approach is that the principal interest of most "all purpose" examiners lies in the safety and soundness area and consumer compliance is viewed as a low priority detail.

In the days when Truth in Lending was the only federal consumer law enforced by the federal banking agencies, it may not have made sense for a set of examiners to specialize in consumer compliance. Today, given the full panoply of consumer laws and especially the challenging community development issues raised by CRA implementation, there is a sufficient level of expertise required to warrant specialization in consumer compliance for a segment of the examiner force.

Full-fledged specialization in consumer compliance -- commonly called a separate career path -- entails separate recruitment, specialized training, and promotion as a consumer examiner. This is the best means to develop the expertise and incentive structure necessary for a vigorous consumer enforcement program. When examiners whose primary function lies in the safety and soundness area are detailed to perform consumer exams, they are not as knowledgable in consumer compliance as consumer specialists and are less likely to pursue consumer problems with vigor. Also, with specialization there is more incentive for the agencies to develop strong examiner training programs in the consumer compliance area. Further, a separate career path in consumer compliance enhances the chances that outstanding performance in conducting consumer exams will be rewarded with promotion. Finally, recruitment for positions as consumer examiners is more likely to attract individuals with underlying interests in community reinvestment, civil rights, and consumer protection than recruitment for general examiner positions with its inevitable emphasis on safety and soundness exams.

The FRB employs full-fledged specialization and a separate career path for consumer examiners. In sharp contrast, the other agencies generally give only limited consumer compliance training to all examiners and then detail some examiners, especially new examiners, to perform consumer exams for limited periods.

The OCC does not use to any great extent examiners who are consumer specialists. All OCC examiners receive the same training, which has a heavy emphasis on safety and soundness examination, and follow the same career path. OCC examiners rotate back and fourth between safety and soundness exams and compliance exams. The FDIC's approach is essentially the same as the OCC's -- general reliance on "all purpose" examiners to conduct consumer exams. In 1979 both the OCC and the FDIC opted for specialized consumer examiners with separate career paths, but these policies were abandoned in the 1980's.

The FHLBB, like the OCC and the FDIC, does not use consumer specialist examiners. FHLBB examiners receive only minimal training in the consumer compliance area and the consumer compliance portion of FHLBB exams is generally very truncated.

C. On-sight Consumer Exams Conducted at Least Once Every 24 Months

Section 411 would also require the OCC, FRB, FDIC, and FHLBB to conduct an on-sight consumer exam at each institution at least once every 24 months. The agencies have traditionally operated with a 12 or 18 month examination cycle, although problem institutions have been examined more frequently. When the interval between consumer exams becomes too extended, the examination process looses its deterrent function and consumer compliance problems become much more difficult to correct.

The FRB currently conducts consumer exams at banks with satisfactory compliance ratings once every 24 months and more frequently at banks with unsatisfactory ratings. During the 1981 to 1986 period, the FRB operated with an 18 month consumer exam cycle for banks with satisfactory ratings. Prior to 1981 the FRB had a 12 month consumer exam cycle.

In 1987 the OCC stopped conducting regularly scheduled consumer exams at national banks with less than $1 billion in assets. Instead, the OCC selects each year a random sample consisting of 16% of the national banks in this size category and conducts a "compliance" exam, which includes the consumer exam, at each of the sample banks. This crapshoot approach to scheduling consumer exams results in an average interval between exams of 6 years for all banks in the sampling system, but means that some banks may not be examined for as long as 10 or 15 years. For national banks with $1 billion or more in assets the

OCC conducts consumer exams once every two years.

The FDIC currently has a policy goal of conducting consumer exams at state chartered nonmember banks once every 3 years. However, in 1986 the FDIC conducted consumer exams at only 1 out of every 6 banks that it supervises, which implies a de facto consumer exam cycle of 6 years. Similarly, the FHLBB has a policy goal of conducting consumer exams at savings associations every 3 years; but, within some Federal Home Loan Bank Districts the de facto consumer examination cycle is as long as 6 years.

Over the last few years the OCC has begun to place more emphasis on off-sight analysis of data reported by banks as an alternative to on-sight examinations. In the consumer compliance area, off-sight analysis of reports filed by banks is an important component of a strong consumer compliance program, but it is not an adequate substitute for on-sight examination. Most types of consumer violations cannot be detected by off-sight review, but instead require on-sight review of bank documents and practices. On-sight examinations are particularly crucial in determining compliance with equal credit opportunity laws and evaluating Community Reinvestment Act (CRA) performance.

VII. A COMMUNITY REVIEW BOARD AT EACH FEDERAL RESERVE BANK

Section 412 of H.R. 5094 would direct each Federal Reserve Bank to establish a community review board that would review the consumer and community reinvestment enforcement activities of the Federal Reserve

Board (FRB), Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and Federal Home Loan Bank Board (FHLBB) at the appropriate regional level.

Each community review board would be comprised of 16 members: 4 representatives of consumer organizations; 4 representatives of community organizations; 4 representatives of civil rights organizations; and 4 representatives of regulated financial institutions. Each of the four federal banking agencies (FRB, OCC, FDIC, FHLBB) would appoint 4 of the members to each community review board.

The community review board would focus on the consumer and community reinvestment policies of the federal banking agencies as they are implemented by the regional units of these agencies. The regional regulatory units consist of the 12 Federal Reserve Banks, the 12 Federal Home Loan Banks, the 6 OCC District Offices, and the 9 FDIC Regional Offices. Within the federal banking agencies, the examination and supervision function is executed primarily at this regional unit level. Moreover, these regional units exercise considerable discretion in the manner in which they implement consumer, non-discrimination, and community reinvestment policies set at the federal level.

In the case of the 12 Federal Reserve Banks and the 12 Federal Home Loan Banks there is an additional rationale for community review boards at the regional level. Financial institutions elect a majority of the directors of each Federal Reserve Bank and Federal Home Loan Bank and consequently these regional units have an inherent institutional bias that leans toward financial industry perspectives and against countervailing consumer and neighborhood viewpoints.

Section 412 of the bill would, in effect, consolidate the regional review function across all four banking agencies, rather than establish a separate community review board for each regional unit of each federal banking agency. Conducting the review function within consolidated regional review boards has a number of advantages. First, it will be much more efficient for the consumer, community, and civil rights group representatives who sit on a regional review board to provide advice on consumer problems and local community credit needs to all four regional regulators on a simultaneous basis. Second, it will be very useful for a regional review board conducting review activities to compare the consumer compliance practices and procedures of the four regional regulators.

Section 412 of the House bill directs each community review board to perform the following functions:

(1) advise the regional regulatory units concerning consumer problems in banking and local community credit needs within the region;

(2) review the regional regulatory units' performance in the consumer enforcement area, including their examination practices and procedures, supervisory actions, and consumer complaint handling practices;

(3) submit recommendations to the regional regulatory units concerning their examination, complaint handling, and enforcement practices and procedures;

(4) prepare an annual report summarizing its activities.

A community review board would meet quarterly at the office of the appropriate Federal Reserve Bank. Its members would serve without pay, but would be reimbursed for travel expenses. A community review board would select its own chairman and any other officers by democratic procedures, rather than having them handpicked by the regulatory agencies. Each Federal Reserve Bank would be required to provide modest administrative support to enable the community review board to perform its duties.

The advisory activities of the community review board would provide valuable information to the regulatory agencies at their primary operating level-- the regional unit. Local input is particularly crucial in regard to CRA implementation, since credit needs vary from community to community. Obviously, local community organizations are key entities with such knowledge. The creation of community review boards with community representatives as members is likely to encourage community groups to provide more CRA related information to the regulators, an explicit goal of CRA implementation. Also, local consumer, civil rights, and community groups are likely to have timely knowledge of unfair banking practices or credit discrimination problems as they emerge in local banking markets. Thus, community review boards will provide regional units with an early warning system in regard to a broad range of consumer, equal credit opportunity, and community reinvestment issues.

Moreover, consumer, civil rights, and local community organizations will benefit from the participation of their leaders and staff on community review boards. This involvement will appreciably enhance their understanding of the financial regulatory process and how it is applied to consumer compliance issues.

The review activities of the community review boards would provide much needed oversight of the federal banking agencies' consumer enforcement activity at the regional level. Although the consumer policies and procedures of these agencies are generally set at the federal level, there is, nonetheless, considerable discretion and variation in enforcement among the different regional units of the same agency. This stems from the fact that examinations and supervisory responses are generally managed at the regional office level, although subject to review at the federal level. Moreover, variation in examination and enforcement is particularly significant among the Federal Reserve Banks and the Federal Home Loan Banks, which are partially autonomous entities within the Federal Reserve System and the Federal Home Loan Bank System.

The community review boards would monitor the scope of resources that the regional regulatory units are allocating to consumer exams and the adequacy of their examination, complaint handling, and supervisory practices and procedures. For example, a community review board could review whether the regional units in its district area are (1) employing examination procedures that adequately test for discriminatory pre-screening of mortgage loan applicants, (2) requiring satisfactory reimbursement for Truth in Lending violations, (3) obtaining appropriate relief for consumers who have filed complaints, and (4) making sufficient use of outside contacts in the conduct of CRA evaluations. A community review board can perform these oversight activities without the need for direct access to consumer compliance examination reports -- the reports in which examiners describe a bank's violations of specific consumer protection and fair lending laws and regulations. These examination reports are separate from the CRA examination reports, which would be disclosed under Section 405 of H.R. 5094.

The recommendations of the community review boards would focus on ways in which regional units can improve their examination practices and procedures and supervisory responses in order to better protect consumer, minority, and local community interests. These recommendations will be based on a community review board's knowledge of consumer problems in local banking markets and its review of the regional units' performance in the consumer enforcement area.

Some recommendations concerning examination practices and procedures and supervisory responses will have broad application. Other recommendations may call for more intensive examination or a stronger supervisory response only in regard to specific problems that have been brought to a consumer review board's attention. For example, a community review board could recommend that the regional units notify local banks that a particular banking practice injurious to consumers is viewed as an "unfair banking practice" and will be subject to supervisory criticism. If a community review board is concerned that certain banks in a local community are not adequately serving small business credit needs, it could recommend that the appropriate regional unit obtain more information on the small business lending performance of these banks during its next CRA exams. In a situation where a community review board is concerned that a particular bank may be engaging in discriminatory lending practices, the community review board could recommend that the regional unit conduct a more in-depth analysis of the bank's loan application data or employ testers.

The annual reports of the community review boards would summarize their review of the scope of the regional units' resource commitment to consumer enforcement and the adequacy of examination, complaint handling, and supervisory practices and procedures. The annual report would also discuss the community review board's recommendations to the regional units. These annual reports should prove to be an invaluable tool in the effort to make the banking agencies more accountable to consumer, civil rights, and local community concerns. In particular, by providing much needed information on the conduct of consumer enforcement at the operational level within the banking agencies -- i.e., the regional unit -- the reports will greatly enhance the ability of Congress to engage in effective oversight over the banking agencies.

The CHAIRMAN. Thank you, Mr. Fishbein.

Mr. Fishbein, in yesterday's hearings Mr. Johnson of the Federal Reserve Board offered a two-part amendment to the CRA that he believes would cure many of the current act's shortcomings, which were heard in our March hearings to which you have referred.

He said, and I am quoting:

> First, appropriate Federal financial supervisory agencies should publish approximately every 2 years an evaluation of each financial institution's record of performance under CRA. This evaluation would provide the public with the basis for the regulatory agencies' analysis of the regulatory performance of each financial institution.
>
> Second, the public should be invited to submit comments regarding this evaluation and the institution's performance record as an essential part of this program, the Federal financial supervisory agencies should be required to take these public comments into account in reviewing expansion proposals by the institution.

That was the Federal Reserve Board's proposal as expressed by its vice chairman.

What do you think of that proposal? Do you think it would deal with many of the shortcomings of the present CRA? And why or why not?

PROPOSAL BY FED

Mr. FISHBEIN. First of all, Mr. Chairman, I think it is an important step forward. It is important for the Fed to recognize the need for more access to information about the performance of local banks.

The key as to whether these provisions will be useful or not is the degree of specificity contained in these reports; whether these reports will report on a specific facts for each assessment item the conclusions reached by the examiners, and whether they include a rating so that the public can judge for itself the relative merits of the lending records of different institutions.

From what I heard Mr. Johnson say yesterday, these items were not a clear part of the Federal Reserve Board proposal.

The second point is that just disclosure alone would not be sufficient. Public disclosure of CRA evaluations is an important step forward, but unless it is part of the package of other CRA reforms that are included in title IV, we do not feel that it would substantially improve the agencies' enforcement record.

Ms. Brown, the American Bankers Association has submitted testimony in yesterday's hearings in which it stated:

> Under the new CRA regulatory framework a bank or bank holding company must achieve a good or an excellent rating in order to conduct normal operations and transactions for which regulatory approval is required. That framework clearly contemplates and indeed mandates that over time all bank holding companies will have to have an above-average CRA rating.

Do you agree with that assessment, and if you do, don't you think the average grade in the proposed rating system is a misnomer? They all have to be above average.

Ms. M. BROWN. Absolutely. I agree that they have to have an above-average rating—period.

The CHAIRMAN. Let me just interrupt to say if you have an above-average rating, that means that half the banks are out of business.

Ms. M. BROWN. But, you see, they are all across the board getting above-average ratings, and they're not doing the job anyway. So, it's like you say, a misnomer.

The point is—back to the first part of your question—will we accept less? No. We have always been asked to accept less. Poor and working poor people in this country have always been asked to wait a little while, "We're getting it together. We will get back to you."

No, we will not accept less. We want this whole title IV package. It's not fair to accept less. I can't do that. We will never do that.

The CHAIRMAN. Well, you see the problem, we feel we have got to have a situation where banks can operate and in which they can reasonably fulfill the requirements of the law under the Community Reinvestment Act. At the same time, if you have 50 percent of the banks that do, that would mean that 50 percent of the banks don't have it, and that means you would knock out 50 percent of all the banks in the country from providing services.

That is why "average" is such an unfortunate term.

Ms. M. BROWN. So, the 50 percent that do, can move on into other areas once they have proved that they have adhered to the law. The other 50, I could care less about them.

The CHAIRMAN. You may not care about them, but of course that means that half of the people in the country have deposits in banks that are declared unable to operate further services.

What I am saying is that we ought to have a standard that doesn't say that you're going to knock out 50 percent of the banks. It would seem to me that it's much more reasonable to say that you have a standard and it may be that the standard is not as satisfactory as we would like it, it may be that we would have to exclude 5 percent of thee banks, 10 percent of the banks.

But anything that is that extreme, it seems to me, does not achieve a practical, realistic purpose.

My time is expired.

Ms. M. BROWN. Senator Proxmire, could I say something?

The CHAIRMAN. Sure.

Ms. M. BROWN. The CRA was passed in 1977.

The CHAIRMAN. That was my bill. I was the author.

Ms. M. BROWN. I commend you for that. It is now 1988. Why is that we should be expected to give 50 percent of the banks a break because they haven't been adhering to the law? It's the law.

The CHAIRMAN. I am not saying give them a break. I have been one of the strongest critics of the notion that only eight out of several thousand have been failed. That is a very proper criticism.

On the other hand, to say everybody who is not above average is out, is unrealistic and unworkable.

Ms. M. BROWN. We are not putting them out of business. We are forbidding them from moving over into the other business ventures that they want to move into.

The CHAIRMAN. Senator Graham.

ESTABLISH A STANDARD

Senator GRAHAM. To follow up on the question that Senator Proxmire was just asking, would it not be more feasible to establish an absolute standard: "This is what is expected in order to be in compliance with your CRA obligations," and then certify either on a pass-fail basis that you met that standard or that you did not? I would be interested in your comments.

Ms. M. Brown. We already have that bill in the CRA. That is our whole point. It is not being followed.

Senator GRAHAM. From the line of questioning, I was under the impression that the way it is being interpreted, at least semantically, is that you have to be above average, which unless you are going to engage in oxymorons, means that half of the institutions by definition could not meet that standard, whereas if you had an absolute standard, then you would have a benchmark to which every institution could strive and potentially meet it.

It would be like saying to a group of athletes the standard is to run 100 yards in 10 seconds and all who meet it qualify. If you say an average, no matter how fast you run, only half will be able to meet the standard and the other half will be considered failures.

Mr. JONATHAN BROWN. Senator Graham, could I comment on that? I think the chairman's characterization of the bill was too harsh, because the bill says that to get an application approved you either have to have a two rating, which is above average, or a three rating, which is average, and if you have a three rating you simply have to make commitments to improve your performance. So, at the starting block, when you start the race in a sense, the vast majority of institutions would be eligible for approval of their applications.

Now, it also says in the committee report on the House bill that the committee expects that with improvement in industrywide performance, that the agencies will be free to assign one and two ratings to a great number of banks, including the vast majority.

I think what the committee was really saying was that initially a three rating, the middle rating, shall be the average practice prevailing in the industry.

I think there is a good reason for that. To promulgate some kind of objective standard right now is rather difficult because the agencies haven't done a good enough job in collecting material and assessing CRA performance.

So, somewhat ironically, what we are saying is that it is impractical to really promulgate objective standards right now. But over time, with more experience and a clearer understanding of what the average performance level is in the industry and a chance for the agencies to see improvement in that level, then down the road they would develop more objective standards.

I think it is fair to say that the House bill says let's use average as the starting point but down the road we won't be locked into a position whereby only a minority can qualify.

So, I think that problem has been dealt with. One can say, for example, that average means average for a 5-year period, and then you promulgate a more objective standard. I think as a practical matter they have addressed the problem.

Senator GRAHAM. At yesterday's hearing the Comptroller of the Currency, Mr. Clarke, made the statement that the effective functioning of the CRA depended on a partnership and that partnership included regulators, banks, and the communities that were being served. He made the observation that he felt that that third part of the partnership, the communities, had not been carrying their appropriate responsibilities, and cited the fact that frequently examination of the file of a bank by a regulator will be void in terms of comments by community members or groups as to how well that bank is serving the community.

I asked Mr. Clarke if he felt that there was a role for the regulators in terms of trying to stimulate more community involvement through training sessions or other ways in which community groups could be advised, educated, and given greater capacity to be a meaningful participant.

I am interested in your observations as to whether Mr. Clarke's assessment of the role of community groups is accurate; and if so, what remedial steps would you recommend might be appropriate?

Mr. FISHBEIN. If I can respond to that, I find the remarks somewhat puzzling because a partnership implies that there is more than one partner. Right now, the only partner in enforcing CRA has been the community groups. They have raised issues through CRA protests at the application stage. The agencies have acknowledged for whatever reason that they have been unable to adequately perform their own supervisory responsibility through the examination process. They claim that is changing, but I think even they acknowledge that there have been deficiencies in the past. So, the partnership has really been one-sided.

In terms of community participation through the comment file, it has been our experience that very few groups know about the existence of these things. The agencies have done very little to promote the awareness. And second, under the existing system, if a comment is filed, there need not be a response from the regulatory agency.

In effect, the community groups, are commenting into a black box. They do not know whether there is anyone at the other end of the line. That is why we think CRA disclosures, which would give the community feedback as to what their comments mean and how they are being weighed by the regulatory agencies would be very important.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Let me ask first that a statement of mine on today's hearings be included in the record.

The CHAIRMAN. Without objection. I also have a statement from Senator Sasser that will be inserted in the record.

STATEMENT OF SENATOR DONALD W. RIEGLE, JR.

COMMUNITY AND CONSUMER BENEFITS IN HOUSE BANKING BILL

SEPTEMBER 9, 1988 -- 10:00 a.m.

Today, we hear from witnesses whose groups have worked tirelessly in an effort to make sure that our financial laws are fair to consumers and to communities and that local community economic development is encouraged

We are currently conducting our own review of problems that have been brought to our attention in Detroit so I hesitate to consider that situation now. However, we have reviewed the Atlanta situation, and the statistical allegations are alarming.

In Atlanta it is alleged that:

*Banks return an estimated 9 cents of each dollar deposited by blacks in home loans to black neighborhoods; they return 15 cents of each dollar deposited by whites in home loans to white neighborhoods. If true, this constitutes a serious disinvestment problem.

*The largest banking institutions take home loan applications in offices predominantly in white neighborhoods. Several banks have recently closed offices in black areas, yet opened them in white neighborhoods.

*Two lenders that volunteered rejection data showed they turned down black applications four times as often as white applicants.

The Committee heard concern yesterday from one thrift lender that making loans to minorities and low income groups can be risky. Well, according to the Atlanta study, the bank with the lowest default rate on real estate loans of any bank its size in the country is a black-owned institution that lends almost exclusively to black neighborhoods.

Our witnesses today have championed the need for basic banking services for all Americans. When it comes to community reinvestment, these groups have served as the front line in highlighting discrimination. That should be the task of our regulators.

It is encouraging that a number of the regulators and bankers that the Committee heard from yesterday embrace the public merits of community reinvestment goals, and acknowledge that improvements can be made. Specifically, there is emerging agreement that CRA assessments be disclosed and that examinations be more vigorous, possibly by specialized supervisors. A renewed commitment to community reinvestment is important and, Mr. Chairman, I commend you for your past and current leadership in that effort.

STATEMENT OF SENATOR JIM SASSER, SENATE BANKING COMMITTEE, SEPTEMBER 9, 1988

MR. CHAIRMAN, I AM PLEASED THAT WE ARE CONTINUING OUR HEARINGS ON THE CONSUMER PROVISIONS OF THE HOUSE BANKING BILL. AS THE TESTIMONY TODAY WILL INDICATE, MANY OF THESE PROVISIONS ARE WORTHWHILE AND WILL BE OF GREAT BENEFIT TO CONSUMERS. MOST IMPORTANTLY, MANY OF THESE PROVISIONS CAN BE ENACTED WITHOUT AFFECTING THE SAFETY AND SOUNDNESS OF THE BANKS.

I THINK IT'S STARTLING HOW MANY FAMILIES IN THIS COUNTRY DO NOT HAVE ACCESS TO BANKING SERVICES. PEOPLE ARE PAYING UP TO 6% OF THE FACE VALUE OF A GOVERNMENT CHECK TO CASH THAT GOVERNMENT CHECK AT A CHECK CASHING "EMPORIUM." EVEN CUSTOMERS OF BANKS ARE OFTEN REQUIRED TO HAVE THE BALANCE ON DEPOSIT BEFORE THE BANK WILL CASH THE CHECK.

ADDITIONAL VIEWS OF JOSEPH P. KENNEDY II

The Community Benefit provisions of Title IV of the Depository Institutions Act of 1988 are intended to strengthen implementation of the Community Reinvestment Act of 1977 (CRA) so that it becomes a more effective tool to encourage institutions to affirmatively serve local community credit needs.

The Committee has determined that the fundamental cause of inadequate CRA implementation is weakness in agency procedures. Accordingly, the road to reform lies in improving the quality of CRA evaluations, increasing agency accountability by greater disclosure, and strengthening the CRA rating system. Finally, if bank holding companies are to enter new financial industries, the public deserves to know that they are doing a good job fulfilling their responsibilities to their own local communities. To this end, Section 405 of the bill contains a series of amendments to the Community Reinvestment Act of 1977 that are designed to strengthen the CRA examination, evaluation, and rating process. These provisions complement Secions 403 and 404 of the bill, which set more rigorous community reinvestment standards for approval of certain bank holding company and savings and loan holding company applications relating to interstate banking expansion and non-banking activities.

WEAKNESS IN CRA EVALUATION AND RATING

A CRA evaluation and rating system lacking credibility undermines CRA implementation in a number of ways. When CRA ratings lack legitimacy, the rating process ceases to be effective as a tool to encourage improved CRA performance. Moreover, community organizations are more likely to protest applications if they have little confidence that the agencies are using the examination and rating process to encourage CRA improvement. The processing of protested applications can require more time becuase the CRA exams carry little weight and an adequate record on the applicant's CRA performance must be contstructed practically from scratch while the application is pending. Banking institutions are eft in the dark as to what is expected in the way of CRA performance. Institutions that have exemplary CRA performance records do not receive proper recognition. The failure of agencies to identify instititutions with strong CRA performance inhibits both the agencies and the Congress from developing new incentives for high performance institutions.

PUBLIC DISCLOSURE OF CRA EVALUATIONS AND RATINGS

Section 405 of the bill directs the agencies to publicly disclose the non-confidential section of their CRA examination reports. This basic CRA document is to contain an agency's conslusions for each CRA assessment factor, a discussion of the facts supporting these conslusions, and the CRA rating assigned to the institution. The language of the statue calls for disclosure of the relevant section of the CRA examination report, rather than a sanitized summary of the report of=r some other evaluation document. Recent experience with CRA implementation by the New York State Banking Department has shown clearly that disclosure of mere summaries of CRA exam reports does not provide much insight into the CRA evaluation process.

Although bank examination reports, including CRA exam reports, have traditionally not been made available to the public, the Committee found public disclosure of CRA exam reports to be essential if the public and bankers are to acquire a clear understading of the standards used by the agencies in CRA evaluations and ratings. It is only by reviewing how the agencies have evaluated the facts and rated CRA performance in specific cases that one can gain a sense of the underlying standards. Second, the CRA exam report is the basic work product of the CRA examination and as such provides a good measure of the quality of agency CRA exams. Public disclosure will exert much needed pressure on the agencies to improve the quality fo their CRA examinations. The agencies have recognized the usefulness of recieving public comments at the time of a CRA exam -- rather than waiting until an application has been filed -- but, the wall of secrecy surrounding CRA exam reports has discouraged public participation at this stage. Finally, public disclosure of CRA ratings and exam reports will in and of itself proveide an important incentive for institutions to improve their CRA performance. Banks, with excellent CRA ratings will receive public recognition they deserve for theri outstanding CRA performance. The bill reported by the Committee contains safeguards to protect privacy concerns and prevent disclosure of any material which the agencies judge to be inappropriate for public review.

CRA EXAMINATION FORMAT

Section 405 of the bill directs the agencies to jointly develop an examination format to be used by CRA examiners to collect data on an institution's CRA performance. For institutions with assets of $100 million or more, this examination format would minimally include performance data on the following factors: housing loans in low and moderate income neighborhoods or equivalent areas; small business and small farm loans; support for community developmenty entities and projects; participation in special loan programs; and affirmative marketing activities.

One of the most serious weaknesses in the CRA examination and evaluation process has been the failure of the agencies to collect and analyze the pertinent data on CRA performance. The CRA evaluation process will continue to be stymied unless agencies can obtain information in a format that is uniform and understandable.

A number of banks have expressed concern that regulatory agencies have placerd too much emphasis on housing loans in assessing CRA performance. In large measure, this reflects the fact that CRA examiners do not obtain much information on an institution's small business loan portfolio. To cure this imbalance in the collection and analysis of CRA performance data the Committee has included small business loan data in the CRA examination format for institutions with assets of $100 million or more. A number of banks as well have emphasized to the Committee that they should receive full recognition for their support of community development activities and administrative support for neighborhood lending. We have specifically directed the regulatory agencies to give bank and savings and loan holding companies full credit for the progressive investment policies of their non-bank subsidiaries.

RATING METHODOLOGY

Section 405 of the bill specifies that the underlying goal of the CRA rating process is to meau=sure the extent to which an institution is committing financial and managerial resources to community reinvestment activities. This assessment is very different from the traditional compliance versus non-compliance analysis that is employed by the agenies to determine whether institutions are complying with very specific consumer protection laws. Implicit in this general reference to resource commitment is the notion that institutions should have considerable flexibility in how they serve locla community credit needs. The underlying credit needs which are the primary focus of CRA are well understood -- low and moderate income housing loans, small business and small farm loans, support for local community development entities and programs, and technical assistance. The rating methodology articulated in the bill seeks to assure that institutions have flexibility in how they addressthese and other credit needs that are more particular to their locla communities. For example, a retail bank would naturally concentrate on direct lending at the neighborhood level, while a wholesale bank might serve the same underlying credit needs by committing substantial resources to community development entities.

Section 405 of the bill also directs the agencies to rate an institution's CRA performance on a comparative basis relative to the CRA performance of other institutions with similar resources. Under present circumstances, this comparative framework for assigning CRA ratings is the only practical approach. Given the limited agency experience with rigorous CRA evaluation, it would be unrealistic to require the agencies at this time or in the immediate future to set objective CRA performance standards that would correspond to the different CRA rating categories. The far wiser course chosen by the Committee is to require the agencies to use the CRA examination and evaluation process to obtain better information on the different levels of CRA resource commitments among institutions and to compare each institution with its peers.

RATING SCALE

Section 405 of the bill directs the agencies to assign numeric CRA ratings to individual banks on the basis of the following 5-grade performance scale: #1-excellent; #2-good; #3-average; #4-limited effort; and #5-poor or substantial non-compliance. The CRA rating scale currently used by the commercial bank agencies employs the following rating categories: #1-strong; #2-satisfactory; #3-less than satisfactory; #4-unsatisfactory; #5-substantially inadequate.

The agencies' rating scale has performed poorly as a CRA encouragement tool and, in fact, has been a principal cause of CRA rating escalation. With 3 rating categories reserved for varying degrees of unsatisfactory performance, this scale is better suited to the traditional tsk of measuring compliance versus non-compliance with precise consumer protection laws. By adopting a performance scale that essentially placed CRA evaluations on a pass/fail basis (or some would assert, a "pass/pass" basis), the agencies have engaged in wholesale rating escalation.

The rating scale required by Section 405 of the bill will provide a more appropriate yardstick by which to meausre an institution's level of resource commitment to community reinvestment activities. The revised scale is anchored by a middle rating (#3) that is defined as "average" in order to reinforce the comparative nature of the rating process. By contrast, the agencies' current scale lacks an anchor, since there is little agreement as to what constitutes "satisfactory" CRA performance. The Committee's scale will give the regulators more flexibility in rating institutions without stigmatizing their performance as "unsatisfactory." Most important, by defining a #3 rating as "average," the Committee's scale will tend to discourage the agenies from automatically assigning #1 and #2 ratings to almost all institutions -- the curent pattern of rating escalation that has so weakened CRA implementation. The term "average" is intended to mean, at least initially, the CRA performance level that is currently most prevalent with the banking industry. With gradual industry-wide improvement in CRA performance over time, ratings may improve in the future. However, this scale is intended to discourage agencies from continuing the rating escalation of the past.

The thrust of this legislation is to send a clear message to the regulatory agencies. The Community Reinvestment Act means what it says: financial institutions have an affirmative responsibility to meet the credit needs of all member of their local communities.

OBVIOUSLY, THESE ARE PROHIBITIVE BURDENS FOR LOW INCOME AND RETIRED PEOPLE. AND THEY ARE UNNECESSARY. I DO NOT BELIEVE THAT REQUIRING BANKS TO OFFER BASIC BANKING SERVICES WILL AFFECT THEIR SAFETY AND SOUNDNESS.

AND IT'S CLEAR THAT BANKS CAN BE BETTER IN THE AREA OF COMMUNITY REINVESTMENT. REDLINING IS STILL A FACTOR IN MANY OF OUR URBAN NEIGHBORHOODS. WHETHER WE NEED TO GO AS FAR AS THE HOUSE BILL DOES ON CRA IS ANOTHER QUESTION; THERE WE COULD HAVE A SAFETY AND SOUNDNESS IMPACT.

MR. CHAIRMAN, I THINK THAT MANY OF THESE PROVISIONS SHOULD BE ENACTED. INDEED, THEY WOULD ENHANCE THE PROXMIRE BILL, AND HELP MAKE IT MAJOR STEP FORWARD IN BANK SERVICE TO BUSINESSES, CONSUMERS AND COMMUNITIES. THANK YOU.

Senator **Riegle**. Let me also say again how much I appreciate your leadership in having these particular hearings today and also the testimony of the witnesses that are here and, more than that, their commitment to these issues and of their organizations to these issues.

It is not easy to work with these questions because they are complicated and money is always scarce to finance the kind of public interest efforts that are represented here. So I appreciate the commitment and the point of view that the people here have developed and are bringing to us.

I want to say one other thing at the outset, Mr. Chairman, and that is that as we approach the end of this session in Congress and the end of your Senate career, I think it is fair to say that there has not been anybody as consumer oriented, that I have seen, as the chairman, the Senator from Wisconsin.

Time after time we have been referring to—even here today—major landmark legislation that affects consumers' rights, consumer standing, fairness in our financial system. Senator Proxmire has been in the lead over more years than most of us can remember in bringing about the whole pattern of changes of law, disclosure, fairness, and equity that have changed things very dramatically in the country. Some of the things we now take for granted in the way of disclosure and access to information didn't use to be that way. He has set that standard in terms of his leadership and chairmanship of this committee.

I want to say today to him, and to others I hope to continue in that vein. I feel very strongly about many of the advances that we have made. I not only don't want to see them rolled back, I would like to see that as time goes on, as we learn more and see more, that we can make further advances, and just as this committee is interested today in hearing from you that are here and others like you, the committee in the future insofar as I have the chance to help direct it will have the same interest and determination because I think it is very important that we have the chance to examine these questions from all points of view. The public interest groups I think serve a very important purpose and I want to make sure that those points of view are heard, weighed, and carefully considered in the future.

So, Mr. Chairman, I want you to know that having served myself on this committee now for 12 years and having watched you in a number of ways, that my intention—and I think it is shared by many of our colleagues on the committee—is to want to continue in the same vein in terms of a lot of the special, extraordinary leadership you have given, and today in a sense is an illustration of that, and I thought this was a good time to make that point.

Having said that, let me ask you, Mr. Fishbein, one of the central issues in community reinvestment is the safety and profitability of lending into what could be called lower income neighborhoods or neighborhoods that are experiencing some difficulty.

CONFLICTING REPORTS ON LOAN EXPERIENCES

Yesterday we heard conflicting reports—I don't know whether you indicated whether you were here yesterday or had the chance to see the testimony that was given yesterday. I assume you are generally familiar with it—but we had a Connecticut banker who said he lost money in that kind of a lending activity, and an Ohio banker at the same time who said his default rate was even lower on the CRA loans than the bank's overall portfolio.

I am wondering as we hear those kinds of arguments made by people in banking, what is your reaction to that and how should we weigh those kinds of conflicting responses?

Mr. **Fishbein**. Let me respond this way. These arguments have been raised by bankers from time to time prior to CRA and certainly since the law has been in effect. However, CRA makes it clear that banks are not intended to make unsafe and unsound loans.

Community leaders I know have testified before this committee many times, people like Gale Cincotta and other leaders, and they have indicated that bad loans are harmful to their communities. While they do not want to see bad loans made in their communities, the reality remains that safe and sound loans can be made in even the poorest of communities. There is a business for prudent lending in those communities.

There is enough evidence after 10 years of CRA that demonstrates that community reinvestment works and it can return a profit. It may not be as lucrative as the potential profits from some investments in the Third World, or in energy loans, or other kinds of go-go investments, but as we have seen, sometimes the return on investment for those loans is not very good.

The experience after 10 years of CRA and after many community investment agreements that have been reached between community organizations and local banks is that community reinvestment lending, if done right, can work and return a profit to the institution.

Senator **Riegle**. I want to get to comments from others, but before we do—while you and I are talking here—I just want to make the observation—you cite the Michigan case. The Commissioner in Michigan, Gene Kuthy, who led that effort in the case of Comerica, which is the current case which you have cited to work out agreements and understandings as to how a larger and stronger, more pervasive effort will go on with respect to community reinvestment.

There are a series of other discussions underway with other local lending institutions in the Detroit area now along those same lines, and we are seeing, I think, some very constructive discussions take place.

I raised yesterday with the panelists that we had the idea that maybe we, in addition to having a stronger and more fully operative Community Reinvestment Act apparatus and process and performance, maybe we need in the future also to think about something else, something new, an augmentation of a kind of policy idea that might take us even further down the track, and that is in a lot of the inner city lending, it seems to me in particular, to just isolate that—it can also be applied to a certain kind of rural lending, where I think the risks of success are not as great for the lending proposal if their proposal has been brought in by a small business, an individual, or what have you.

But maybe we ought to be thinking about some kind of a new hybrid arrangement where the Federal Government actually gets involved on the margin with that increment of risk that may in fact be there in some situations so that we don't draw the line so far away from granting credits where there is a higher level of risk, that in fact we cause a downward spiral within an area. It seems to me that if an area can't refinance itself, keep itself vibrant, keep itself strong, that that is almost a certain recipe for going down the drain.

I am wondering if we shouldn't start to at least think aloud about the idea of the Federal Government and the private sector, including citizen groups, finding some combination of ways to maybe identify the element of higher risk that may be associated with some kind of lending and find a way to come in and meet that risk element with a public policy commitment and actually find a way to bring dollars in to match those risks if those risks are realized in terms of loss rates that are higher than ordinary, and it may well be that that is something we need to consider.

I have gone way past my time, and I am retracing something I was thinking aloud about yesterday, but I just want to put the concept on the table so you can start to think about it.

The CHAIRMAN. Mr. Brown, the Community Bankers Association testified at yesterday's hearings that Congress in amending the CRA should limit the ability of protesters to use costly delays to restore money and credit to the banks.

His statement was, and I quote:

"Our approach would be to require an expedited hearing process for CRA complaints so that banks who wish to stand on their CRA records can do so without prohibitive cost."

Do you think that the Community Bankers Association's recommendation to provide an expedited CRA hearing process—does that have any merit? If not, why not? If so, why?

Mr. BROWN. In all honesty, I haven't reviewed the specifics of the proposal. There are a lot of different ways it could be structured; but, I would say in general I don't think there is a particularly compelling case that CRA protests have resulted in inordinate delays in processing applications.

The Federal Reserve Board did a review of the time it took to process CRA protested applications, and they found that it increased the time on average by maybe 1 or 2 days out of a total of 70–75 days.

So the delay involved because of CRA has been minimal. The data does not support the argument that bankers frequently make that there has been substantial delay.

The CHAIRMAN. That is very interesting and a very good rebuttal, and it would be very helpful to the committee if you could document that, that the delays have only been a day or two out of 75 days.

Mr. BROWN. I will be glad to. I think it is unfortunate that the Federal Reserve in its testimony didn't include that.

[The following information was subsequently submitted for the record:]

October 7, 1988

Honorable William Proxmire
Chairman
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Washington, DC 20510

Dear Mr. Chairman:

At the Senate Banking Committee's hearings on Title IV of H.R. 5094 on September 9, 1988, you requested more precise information on the processing time of bank holding company applications that have been subject to protest under the Community Reinvestment Act (CRA). The enclosed table, prepared by the Federal Reserve Board, provides average processing time data for applications filed under the Bank Holding Company Act in 1986 and 1987. The "all applications" category in the table combines both Section 3 applications (bank) and Section 4 applications (non-banking).

The data indicate clearly that CRA protests have not resulted in processing times that are significantly longer than those generally required to process applications that raise substantive regulatory issues. Under the Federal Reserve Board's procedural rules, bank holding company applications that raise a "substantive issue" -- such as, financial condition, management qualification, banking concentration, scope of permissible non-banking activities, or CRA performance -- must be acted upon by the Federal Reserve Board itself, rather than approved under delegated authority by a Federal Reserve Bank. 12 C.F.R. 265.2(f)(22)(iii). In 1987, the Federal Reserve Board acted upon 404 bank holding company applications, 37 of which involved CRA protests. The average processing time for the applications subject to CRA protest was 73 days, compared to an average processing time of 75 days for all 404 applications. These figures should dispel the erroneous impression fostered by the bank lobby that CRA protests are causing unreasonable delay in the processing of bank holding company applications.

Also enclosed is a BankWatch memorandum that analyzes the CRA bill drafted by the Federal Reserve Board as an alternative to Subtitle A of Title IV of H.R. 5094. The Federal Reserve Board's proposed legislation, The Community Reinvestment Act Amendments of 1988 (Sept., 13, 1988), has been circulated widely and is an important part of the current legislative debate on CRA reform. The Federal Reserve Board's bill incorporates an important element of CRA reform -- public disclosure of agency CRA evaluations. On the other hand, as discussed in the BankWatch memo, the structure of the bill raises a number of major concerns on the part of community organizations working in the community reinvestment area.

Finally, BankWatch would like to thank you once again for your strong leadership over the years on behalf of community reinvestment initiatives in banking legislation.

Sincerely,

Jonathan Brown
Director
BankWatch
P.O. Box 19367
Washington, D.C. 20036

Processing Time for CRA Protested Applications Compared with All Applications

CRA protested applications	1986	1987
Total CRA protested cases (approved/denied)	22	37
Median processing time	72 days	60 days
Average processing time	92 days	73 days
Average processing time excluding cases over 150 days	78 days	67 days
Cases resolved within 60 days	8	24

All applications processed	1986	1987
Total cases	2470	2604
Board Action	347	404
Delegated Action	2123	2000
Average Processing Time All Cases	37 days	41 days
Board Action	71 days	75 days
Delegated Action	31 days	34 days

Memorandum Re: The Community Reinvestment Act (CRA) Bill Proposed By
The Federal Reserve Board As A Substitute To
The CRA Provisions Of H.R. 5094

From: BankWatch

Date: September 30, 1988

The Federal Reserve Board (FRB) has proposed Community Reinvestmen Act (CRA) Amendments as an alternative to the major CRA reform provisions contained in Title IV of H.R. 5094. The centerpiece of th FRB's proposal is a requirement that the federal banking agencies make public written evaluations of the CRA performance of individual banking institutions. The FRB's bill addresses only one CRA reform issue (disclosure of CRA evaluations) among the three CRA reform concepts embodied in H.R. 5094: disclosure of CRA evaluations; reform of the CRA rating system; and more rigorous CRA standards for approva of bank expansion applications. This memorandum presents a detailed analysis of the various issues raised by the FRB's bill.

#1. Disclosure of CRA Evaluations.

To accomplish the important goal of informing the public about the CRA performance of individual banks and the underlying CRA standards applied by the banking agencies, the CRA evaluations that are subject to public disclosure should contain the following: (1) the essential facts on a bank's CRA performance; (2) an analysis of the facts as th pertain to each CRA assessment factor; (3) the agency's conclusions f each CRA assessment factor; and (4) the overall CRA rating assigned t the bank and the rationale for the rating. Moreover, the presentatio of facts and conclusions should give special attention to the bank's record of serving the housing credit needs of low and moderate income persons, small business credit needs, and small farm credit needs.

The essential facts of a bank's CRA performance should include information on the following:

(A) Housing loans in low and moderate income neighborhoods or equivalent areas, small business loans, and small farm loans;

(B) Participation in government or private loan programs relating housing, small business, or small farms;

(C) Administrative support, including technical assistance, provid to facilitate neighborhood lending, small business lending, or small farm lending;

(D) Investments, contributions, and administrative support involvi community development programs, projects, or entities;

(E) Credit, investment, and administrative support provided to serv other local community credit needs that have been identified through the bank's ascertainment or public comments as underserved, unmet, or most pressing credit needs.

(F) Efforts to market housing and small business loans in low and moderate income neighborhoods and minority neighborhoods.

CRA examiners, charged with the task of evaluating bank CRA performance, have recognized that this performance information is needed in order to conduct a proper evaluation. In fact, the FRB prior to conducting a CRA exam, directs a bank to submit the following data:

> ...marketing, special credit-related programs and other methods of outreach
>
> ...participation, including investments of human and financial resources, in local community development and redevelopment projects or programs ... Please note the investments by type, dollar amount (if applicable), and date of participation.
>
> ...participation in government insured, guaranteed or subsidized loan programs for housing, small business and small farms ... Please provide the date of funding, original loan amount, and amount outstanding.
>
> FRB, Community Reinvestment Act Questionnaire, Items #2, #5, and #6.

Aside from mortgage loan data provided by the Home Mortgage Disclosure Act, CRA performance data is generally not available to the public. Thus, inclusion in CRA evaluations of a full set of CRA performance information is needed to provide the public with a balanced perspective on CRA performance and also to serve as a reality check on the agency's conclusions.

The agencies have also recognized the importance of requiring that written CRA evaluations pay special attention to a bank's record of serving the credit needs of low and moderate income neighborhoods. The joint agency CRA examination procedures direct CRA examiners to:

> ...develop a narrative for Agency use specifically addressing the institution's efforts to help meet the credit needs of the low and moderate income neighborhoods in its local community.
>
> FDIC, FHLBB, FRS, OCC, Community Reinvestment Act Examination Procedures, at 29.

The specific provisions of the FRB's bill fall far short of the content requirements for proper CRA evaluations. In specifying the content of the written evaluations that will be made public, the FRB's bill refers only to "description of conclusions ... basis for conclusions ... and discussion of the relevant assessment factors." While the language is vague and subject to broad interpretation, it is clear that the FRB -- in keeping with its longstanding negative attitude toward public disclosure of any type information on bank performance -- contemplates CRA evaluations that would be essentially conclusionary, and would not contain the essential facts on a bank's CRA performance. Pointedly, the bill makes no mention of either (1) the essential facts of a bank's CRA performance or (2) an analysis of the facts as they pertain to each CRA assessment factor. Nor does the bill provide for disclosure of the bank's CRA rating and the rationale for the rating. The most that would be required is a discussion of the agency's conclusions for the relevant CRA assessment factors.

The FRB's bill is also flawed because it fails to recognize the critical relationship between CRA evaluations and CRA examinations. Any serious CRA evaluation should be based on the results of a rigorous CRA examination and the fact findings and conclusions of the CRA examiner should shape the written evaluation that is made public. The FRB, driven by a deep-seated paranoia about disclosure of CRA exam reports, has gone to great lengths in its bill to detach the CRA evaluation that will be made public from the CRA examination process. While the CRA evaluation need not be one and the same as the CRA exam report, it should be prepared soon after the completion of a CRA exam and reflect the findings and conclusions of the CRA examiner.

Another objectionable feature of the FRB's bill is that it calls for public comment on a CRA evaluation after it has been prepared and made public. The proper approach is to encourage public comment during a bank's CRA examination -- as the FRB currently does through its "outside contacts" program -- and then incorporate useful information provided by the public into the CRA evaluation. The FRB's proposal is backwards, calling for public participation after completion of the CRA examination and evaluation.

#2. Dilution of CRA'S Focus on a Bank's Neighborhood Reinvestment Performance.

The FRB's bill would codify the CRA assessment factors contained in the existing CRA regulations, but in doing so would modify them in order to blunt their focus on a bank's neighborhood reinvestment record. The FRB's strategy for diluting CRA's focus on neighborhood reinvestment involves a two-pronged attack. First, the bill would assign higher priority to various procedural assessment factors and downgrade the significance of CRA assessment factors that measure a bank's actual CRA performance -- i.e., its loans, investments, technical assistance, and administrative support. Second, the bill would revise the assessment factors that measure CRA performance so that rather than focusing on neighborhood reinvestment and other underserved credit needs they would encompass virtually any type of credit extended within the local community.

The *first prong* in the FRB's strategy is to create an entirely new CRA assessment factor that deals entirely with procedural aspects of CRA and then to elevate this factor above the other assessment factors. Under the FRB's bill, a new procedural assessment factor -- assessment factor (2) -- would serve as an umbrella that incorporates two existing assessment factors (ascertainment of credit needs and affirmative marketing), restructures another existing assessment factor (involvement of the board of directors), and adds three new assessment factors (program to develop lending programs, procedures for using ascertainment findings, and personnel training). This umbrella procedural assessment factor is to be given "special attention" in conducting the CRA assessment.

Ascertainment of community credit needs and affirmative marketing are legitimate assessment factors that have procedural characteristics, especially ascertainment. However, since they are already enumerated assessment factors in the existing CRA regulations, the only purpose served by incorporating them within a new umbrella procedural assessment factor is to give them more weight than the performance-oriented assessment factors that remain outside the umbrella.

Two of the new assessment factors included within the new umbrella procedural assessment factor involve a bank's internal operating procedures: (1) the bank's program for developing lending programs to serve low and moderate income neighborhoods and (2) procedures for incorporating findings regarding credit needs into the development and delivery of products and services. These proposed assessment factors provide strong indication of the FRB's intention to use systems management argot about programs and procedures to cast CRA evaluation adrift from its performance-based mooring.

Clearly, if a bank is not serving the credit needs of low and moderate income neighborhoods, then developing a "lending program" for such neighborhoods is a useful remedial device. However, to evaluate a bank on whether it has a "program for developing a program" is to take two steps away from the reality of the bank's CRA performance. Similarly, a key issue in CRA evaluation is whether a bank is extending the types of credit that match its local community's underserved credit needs, as identified through ascertainment. CRA examiners make this determination by reviewing ascertainment, credit extensions, and affirmative marketing -- all of which are existing assessment factors. If the bank's performance record is satisfactory, then whether it has some elaborate procedure to formally link ascertainment, credit services, and affirmative marketing is somewhat besides the point. On the other hand, if the bank's neighborhood lending performance is weak, then the CRA examiner may want to raise the issue of "procedures" as a remedial device.

There are few, if any, benefits associated with the FRB's proposed emphasis on "programs to develop programs" and "linking procedures" to offset the negative impact of diverting the focus of CRA evaluation away from performance-based assessment factors.. The proposed emphas on systems management will encourage banks to develop elaborate programs and procedures in order to impress CRA examiners. Yet, ther is no demonstrated correlation between the sophistication of a bank's systems management programs and procedures and its CRA performance record. In fact, the best results may be obtained if experienced neighborhood lending officers are hired and given broad discretion to engage in neighborhood lending, with little in the way of a formal structure imposed by upper management. In any event, the agencies should not encourage the bureaucratization of CRA -- in a sense, reshaping it in their own image -- by assigning high priority in evaluations to elaborate internal operating programs and procedures.

What is well established is that a most important ingredient of strong CRA performance is a vigorous commitment to CRA at the top of institution. Elaborate procedures and programs have little to do wit the existence or absence of such commitment. Ironically, the banking agencies themselves, as demonstrated by their weak and inconsistent C implementation, provide strong evidence of this proposition.

Finally, the FRB's emphasis on a new umbrella procedural assessmer factor suffers from a basic methodological flaw. The approach confus CRA performance, which should form the basis for judging a bank's CRA record, and procedural weakness, which is a logical focus for supervisory recommendation when CRA performance is found to be weak. It makes sense for a CRA examiner to scrutinize a bank's programs and procedures, especially when questions have been raised about the bank CRA performance; but, the information obtained in such review is more remedial than a priority CRA assessment factor.

This negative interpretation of the FRB's proposed emphasis on procedural assessment factors is substantiated by the FRB's own publi statements. The current FRB regime has made it very clear that it wants to weaken CRA by redirecting the focus of CRA evaluations away from measures of actual CRA performance and towards procedural matters. Testifying before the Senate Banking Committee on Sept. 8, 1988 FRB Governor Manuel Johnson stated:

> ... the purpose of CRA is to encourage depository institutions to make meaningful efforts to assure that local communities are aware of available credit facilities and to take steps to meet local credit needs in a nondiscriminatory manner...

What Governor Johnson is saying is that as long as a bank has a good marketing program and has avoided discriminatory practices, there is need to evaluate the scope of the resources that it is committing to CRA-type activities. This narrow interpretation would limit the role of CRA to that of a non-discrimination provision, rather than that of statute designed to encourage banking institutions to affirmatively serve the credit needs of their local communities.

The second prong in the FRB's strategy is to dilute the neighborho focus of the performance-based CRA assessment factors. The FRB's bill would accomplish this by broadening the scope of two key existing assessment factors: (i) housing, small business, and small farm loans; and (j) loan programs for housing, small business and small farm loans. The bill would expand these assessment factors to include "any loan made within the local community" and "any type of loan program". This expansion would enable banks to claim CRA recognition for loans such as mortgage loans in affluent neighborhoods or auto loans -- credit types for which there are generally a broad number of competing suppliers and no credit access problems. This approach would clearly undercut the current and appropriate focus of CRA on neighborhood reinvestment.

From the Governor's ideological perspective, focusing CRA on neighborhood reinvestment constitutes impermissible credit allocation. What the Governors will not recognize is that inherent in CRA is the concept that assessment and evaluation of a bank's CRA performance should focus on the extent to the bank is serving the "underserved", "unmet", or "most pressing" credit needs of its local community. As a general rule, extending credit to low and moderate income housing, small businesses, small farms, and community development entities meets this test.

The existing CRA assessment factors could be modified in keeping with the purposes of CRA to recognize explicitly that banks can serve neighborhood credit needs by providing administrative support and technical assistance that facilitates neighborhood lending, as well as by making loans and investments per se. Many CRA examiners do, in fact, recognize the importance of administrative support and technical assistance even though it is not an explicit assessment factor. A new assessment factor to address this point could read:

> (m) Administrative support, including technical assistance, provided to facilitate neighborhood lending, small business lending, or small farm lending;

Moreover, the existing CRA assessment factors could also be legitimately modified to make explicit the general concept that underserved, unmet, or pressing credit needs are not confined to housing, small business, or small farm loans. The proper approach would be to add the following new assessment factor:

> (n) Credit, investment, and administrative support provided to serve other local community credit needs that have been identified through the bank's ascertainment or public comments as underserved, unmet, or most pressing credit needs.

While the Governors may choose to characterize CRA's focus on "underserved" credit needs as impermissible credit allocation, it does not bear any resemblance to "credit allocation" in the normal meaning of the word. CRA allows banks broad discretion to emphasize certain credit needs as opposed to others, and banks may employ a variety of different strategies to serve these credit needs. This is far remov from the portfolio requirements and other quotas that are the hallma of the traditional credit allocation schemes administered by central banks.

#3. CRA Statement.

The FRB's bill would require a bank to annually adopt a CRA statement that described its CRA-related activities. Under the bill provisions, each bank must also maintain a public file that would include its CRA statement and any public comments on the statement, well as the most recent CRA evaluation prepared by its supervisory agency.

The existing CRA regulations require banks to prepare CRA statemen and to maintain public files. Thus, the FRB's proposal is in many respects merely a codification of existing regulations, rather than new reform. On the whole, community organizations have not found CRA statements to be very useful sources of information on CRA performance. They tend to contain only very general information presented with a public relations gloss, rather than precise information on CRA performance that is suitable for analysis.

However, the FRB's bill would require CRA statements to address mo issues than required under the existing CRA regulations. In particular, the CRA statement envisioned by the FRB's bill would require a bank to describe (1) its ascertainment efforts, (2) its efforts to provide services (marketing), and (3) the "results" of its efforts. Under the existing CRA regulations, banks are only "encouraged" -- rather than required -- to include this information i their CRA statements.

The FRB's bill is not likely to remedy the underlying problem with current CRA statements: their failure to provide useful information o CRA performance. They key provision, which directs a bank to discuss the "results" of its efforts, lacks any specificity. Unless some itemization and degree of format is required, banks will in all likelihood continue their present practice of presenting information that is very general and difficult to interpret. The confusion that can result from a lack of specificity is readily apparent. For example, a bank might employ a very expansive notion of local communi development that, in fact, extends way beyond the scope of CRA. Or, bank may loosely refer to its small business lending activities, when in fact it is really talking about medium-sized businesses.

Since most of the facts that constitute a bank's CRA performance record are not in the public domain, it will be extremely difficult f community organization to test the validity of assertions in CRA statements. Given the understandable inclination of banks to use the CRA statements to promote their image, the information presented coul be quite misleading from the perspective of a balanced CRA evaluation.

Moreover, the information presented by various banks will tend to be non-comparable, thus making it extremely difficult, if not impossible, to compare the CRA performance of peer banks.

Another troubling aspect of the FRB's approach is that many CRA statements will be quite lengthy and the banking industry will characterize CRA statements as a reporting requirement. Summing across the industry the total volume of CRA statements and the total time required to prepare them, the bank lobby will claim that CRA has resulted in another major reporting burden. Yet, from the community perspective, the information generated by this requirement will on the whole have only limited utility for CRA evaluation purposes.

#4. Discounting CRA Protests.

The FRB's bill would authorize the agencies to discount the weight given a CRA protest filed in an application proceeding whenever the protesting community group has failed to comment previously on the bank's CRA evaluation or CRA statement. This discounting rule would have the effect of penalizing community organizations for not investing their scarce resources in preparing comments for CRA examinations and evaluations. If the policy goal is to encourage community organizations to participate in the CRA examination and evaluation process, then the only honest and fair approach is for the agencies to prepare and make public CRA evaluations that have substance and legitimacy. When CRA evaluations have legitimacy, then community organizations will have a strong incentive to participate in the CRA examination and evaluation process.

Discounting means that relevant evidence on CRA performance collected by community organizations and submitted in application proceedings will either be ignored or not given full weight. Such an "exclusionary" rule might be appropriate for criminal or formal administrative proceedings. Does the FRB really want to turn CRA examinations and evaluations in to full-fledged administrative proceedings? If it does, then it should give community groups full intervention and discovery rights, and the right to administrative and ultimately judicial review of every CRA evaluation.

Community groups lack sufficient resources to file extensive comments on the CRA performance of a large number of banks in order to preserve their right to effectively protest at some future time the limited number of banks that will submit applications. Thus, the real impact of the FRB's proposed discounting rule would be to chill community group participation in application proceedings, rather than to encourage participation in CRA examinations and evaluations. Groups would be less inclined to protest application out of concern that their efforts would be wasted due to agency "discounting". Moreover, in the absence of greater legitimacy to CRA evaluations, community groups would not be likely to devote resources to submitting comments at the time of CRA examination and evaluation, since the evaluation is removed

PUBLIC DISCLOSURE COULD HAVE A POSITIVE EFFECT

The **Chairman**. Mr. Fishbein, if the CRA ratings were disclosed publicly, some regulators worry that their examiners would face new pressures, banks would haggle about low ratings and high ratings, and this would ignite public criticism.

First, do you think there will be such pressure and, second, if there is, could it be positive? Could it be helpful and constructive—that is, the criticism could be positive? Wouldn't this pressure make the examination and resulting CRA rating more accurate?

Mr. **Fishbein**. I think disclosure would be a good thing. Pressure is another way of stating accountability. It has been our feeling for some time that when you have a system that has been operating the way it has where virtually every institution gets a 1 or 2 rating, there needs to be more accountability built into the system, and requiring the agency to, in effect, demonstrate how they arrived at their conclusions would be a very important thing.

Second, I think it would provide communities with an opportunity to compare the performance of different institutions and decide where they want to place their deposits. It will help create competition in a healthy sense in that it will get institutions to do a better job of improving their records in local communities.

I think that kind of disclosure would work very favorably, and I don't see the negative side effects that the agencies were apparently pointing to yesterday.

The **Chairman**. Mr. Brown.

Mr. **Brown**. Mr. Chairman, I generally agree with what Allen said, but I have a concern about requiring disclosure only in a truncated form where just the rating is disclosed or possibly just a very conclusory evaluation of the rating. My concern is that it may not really tell you much about the underlying basis for the agency's decision.

Certainly, today we have no confidence in the ratings. Just because the regulators begin to disclose them doesn't mean that they will have any more legitimacy. You can't tell just by looking at the rating or even at a summary statement what processes the agency went through in evaluating the bank's performance.

So, I think that it is very important that we get not just the rating or not just a conclusory evaluation, but the underlying CRA examination report, which lays out the process that the examiner went through, the facts that he reviewed, how the facts were analyzed. Then, on the basis of the report you can yourself make a determination: Was the agency's rating justified or not?

But if we don't do it that way, I am afraid we will get into a situation where we may find that there is not much improvement, and in fact we may be putting out into the marketplace ratings for which we still have no confidence.

Here again, I am not satisfied with the Federal Reserve Board's proposal. It is not for lack of willingness to compromise. It is a feeling that you have to disclose the underlying work product if you really want to understand what the standard is.

The **Chairman**. Mr. Brown, during this committee's oversight hearing on CRA in March of this year, Mr. Brentzel, the President and Chief Executive Officer of Freddie Mac said the following:

Freddie Mac has not imposed any restrictions which I believe could adversely affect lenders in carrying out their CRA responsibilities. To the extent that borrowers are told by lenders that their applications have been denied because of increased secondary market restrictions, I am concerned about this. It may be that Freddie Mac is more often an excuse than the real reason that a loan may not be made.

In your judgment, are secondary market restrictions an impediment to banks in carrying out their CRA responsibilities?

Mr. BROWN. There have been over the last 5 or 6 years some banks in particular markets that have taken that position. On the other hand, Fannie Mae argues that its underwriting criteria are not restrictive.

The CHAIRMAN. Does that mean that Freddie Mac would engage in some kind of redlining?

Mr. BROWN. Freddie Mac is the same. Their underwriting criteria are generally the same.

I think it is hard to tell simply by looking at their criteria. Obviously, there is a lot of discretion and leeway as to how they are interpreted by the lender.

But, I think there is a more important factor than their criteria. There are certain types of loans which are nonstandardized, which are very specific to community development, which cannot be securitized, which you cannot sell to Fannie Mae or Freddie Mac.

What I see as the real problem is that banks are increasingly unwilling to make loans unless they are salable to Fannie Mae or Freddie Mac. It is not so much that the secondary market institutions are a problem. It is increasingly that the banks don't want to be portfolio lenders anymore.

That is the real long run concern that we have. The sense that securitization of the banking industry is going to mean that a lot of people who don't fit into that securitization process will have problems getting credit.

The CHAIRMAN. Thank you, sir.

Ms. M. BROWN. Senator, could I comment on that?

The CHAIRMAN. Certainly.

Ms. M. BROWN. Also, in Philadelphia the two banks that we do have negotiations with, one of them at least continually encourages us to go against the PMI's because their hands are more or less tied. The PMI's insist on underwriting the properties. The banks want to lend us the money and have been lending us the money for the properties, but the PMI's have been giving them a hard time, and that might be one way that ACORN in Philadelphia intends to go—with other coalitions—to go out and see what we can do against the PMI's.

The CHAIRMAN. Thank you.

Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you very much.

Mr. Chairman, I just want to say, by the way, I commend you for holding these 2 days of hearings and particularly for bringing the community groups here. I am delighted that Ms. Brown from ACORN in Philadelphia is here, and I commend her on the very excellent work that she does on a day-to-day basis in trying to make sure that the banks in the Philadelphia community really live up to their community responsibilities.

As I said yesterday when this committee invited community groups, last March, to evaluate the performance of Federal banking agencies' enforcement of the Community Reinvestment Act, these groups were tough graders. Each of the bank regulators were given failing grades.

School is now back in session, and the school supervisors, our friends on the House Banking Committee, propose a brand new curriculum, which we are discussing, a lot of remedial courses, a tougher grading system, mandatory examinations every 2 years. Most importantly, under those new rules, the banks would not be permitted to engage in what you might call extracurricular activities, such as starting a securities business, unless they get better than average grades on their CRA exams.

I would like to address a question to an issue that has arisen in the last day or so between the community groups, the banks, and the bank regulators on the subject of disclosing the CRA rating of 1, 2, 3, 4, or 5.

The bank regulators have voiced concerns about disclosing that rating. They don't seem nearly as resistant to disclosure of whether or not a bank is in compliance with the CRA. They say they are concerned about converting a CRA rating into some kind of Federal seal of approval. I guess a 1 or a 2 would be a seal of approval, and a low rating, a bad rating at the bottom would be the opposite.

Interestingly enough, our witnesses from the banking industry indicated that they wouldn't mind being able to brag about having a good rating. It seems to me that such disclosure would be rather encouraging to banks that wanted to attract deposits. In other words, these banks realize that they might get some reward from the system if they, in fact, did perform well.

Is there an opportunity here for community groups to play a role? Is there a way for you to help us solve the problem confronting the regulators by your being more aggressive in praising banks that you know do a good job—and I assume you know of some—so that the banks that aren't doing good jobs get a stronger message?

Let me start with my constituent, Ms. Brown.

Ms. M. Brown. Yes, Senator Heinz. I have publicly—earlier this year when I testified before Congress, I publicly praised Continental Bank in Philadelphia for working with us. Fidelity Bank also has done a tremendous amount of work with us in our communities.

We are not bank haters, we are not bank bashers. We are not out there raising hell just to get attention. That is not our point.

We have a wonderful working relationship with the banks. The rating system—my colleague Mr. Brown here, he is the expert on the rating system, and I would concede any answers to that to him.

Senator Heinz. Mr. Brown.

RATING SYSTEM

Mr. Brown. Senator Heinz, I think you are coming to what I feel is a latent, but ultimately very important, issue here; and that is, if it is possible to put in place a public rating system that is well-founded and has enough information to make the ratings legitimate——

Senator **Heinz**. By the way, I am assuming—and I didn't state this at the beginning—that such a rating system would be developed only after consultation with community groups. It isn't done that way now, but that is the way it ought to be done. I am assuming it would be done right.

Mr. **Brown**. That is right.

And my premise is that it has to be done right if it really is going to be that useful. Because if it is not, it won't have legitimacy; and people won't pay much attention to the ratings if they are not done properly.

But, I think if it is done right there is potentially a very strong demand on the part of many investors for that type of information, particularly since they are putting money in banks where the deposits are insured. So, essentially the difference between banks is not that great, and the yield is pretty much the same.

There are socially responsive investors who would like very much to have a good rating system. These include individuals and institutions. There are State agencies—for instance, State treasury departments—that have deposits upwards of $1 billion which they could shift from one bank to another. Their problem is that they don't have a particularly good handle on how to rate the banks. There has also been a large growth in the socially responsive investment funds.

So, I think there is a great demand. I should also say that our organization receives requests from individual consumers. They would like advice as to where they should put their deposits. And, I know when Senator Proxmire was arguing on the floor of the Senate for the Home Mortgage Disclosure Act back in 1975, I believe one of the arguments he made was that this type of information would ultimately trickle down to the consumer and they would put their money in the bank that had the best record.

The problem is that it is a difficult task to evaluate a bank's performance because there are a number of factors you have to look at, and what has always hamstrung us is that we do not have enough information.

Yes, you can look at the mortgage loans, the information available under the Home Mortgage Disclosure Act. But, if you are looking at commercial banks which do a broad number of many other activities that are very relevant to CRA and if you have a commercial bank that is doing an excellent job in small business lending and is very aggressive in the community development area, it may not be a major mortgage lender. If you are just looking at the HMDA data, you are not making a fair assessment of the performance.

What I am suggesting is that there is a need for the agencies to do a much better job in collecting the relevant information when they do the CRA exam and then writing it down in the examination report and making that examination report available to the public. And then the public can judge: Are the ratings warranted or are they not?

If I am, let's say, a State pension fund manager or a State treasurer, I can look at those examination reports. If I am comfortable with them, then I can use the ratings and conclusions. If I am not, I can draw my own conclusions from the underlying information.

I think the agencies' reluctance to accept this idea of full disclosure of the CRA examination report is not based on any legitimate public policy. Obviously, in regard to safety and soundness examination reports, there are policy reasons for not disclosing them—the possibility of triggering a run on the bank. Even for consumer compliance reports, which may cite violations of consumer credit laws where there is potential legal liability on the part of the bank, there is an arguable case to be made for not disclosing exam reports.

But in terms of the CRA evaluation itself, there is no reason why that information in the examination report cannot be made public. There is no question of liability of the bank. There is no question of a run on the bank.

I think all the arguments are in favor of full disclosure.

Senator HEINZ. May I interrupt, Mr. Chairman? I have just one last question, and then my time is expired.

The CHAIRMAN. You go ahead.

Senator HEINZ. Just to follow up, how would you feel if the bank regulators were required to release the CRA report to the public, where they were required to decide, on the record, who had passed and who had failed but they were not required to assign a specific rating.

Mr. BROWN. You are saying in a sense it would be a pass/fail system?

Senator HEINZ. A pass/fail system, but the CRA exams, the written results, would be on the table.

Mr. BROWN. I think that is an interesting idea especially in terms of the ultimate direction I am coming from. I think that is something that is worth considering.

Senator HEINZ. It may solve—I don't know, there may be other people that don't like it, but it solves the problem regulators have. They are a little nervous about deciding whether one bank is better than another bank. They are nervous, I think, about making subjective judgments of various factors and coming to a conclusion. They think they can do a job of deciding whether people are good or bad. Saying this guy is better than that guy and by how much makes them, I think, rather nervous, and I can understand that.

Mr. BROWN. There are two issues here. One is the issue of the disclosure of the information and the ultimate judgment by the public and investors on the bank's performance, and I think there is some agreement here.

But, there is a second issue—that is, practically speaking, the regulatory incentives for improved CRA performance. They are under the current law linked to a bank's rating as they would continue to be under the proposed reforms.

So, I think you would still have to keep in mind for incentive purposes the need for some kind of rating requirements.

Senator HEINZ. However, this issue is whether or not they make it public. I am not saying that they aren't going to continue to do what they now do. I am just saying what should be released to the public.

Let Mr. Fishbein have a comment.

Mr. **Fishbein**. The point that needs to be stressed is the interrelationship between reforming the CRA evaluation system and the rating criteria and the disclosure of evaluations.

If we are merely making public assessments, which find that 99 percent of the industry has a good rating, then that information is not going to be very useful to anybody. So these things are interrelated.

There needs to be a revised system just to create some downward pressure because if we started tomorrow to disclose each bank's CRA exam report, it would not solve the problem.

The issue here is less of whether as a numeric rating is disclosed than the need to disclose underlying information used to evaluate performance. That really needs to change. It will only change through legislative directive.

Senator **Heinz**. Thank you, that is very helpful.

The **Chairman**. Thank you. This was certainly an excellent panel. We were very happy to have had your testimony.

Our next panel consists of Judith Brown. We have had five witnesses this morning, and three of them have been named Brown. Judith Brown, member of the board of directors of the American Association of Retired Persons in Minneapolis, MN, and Peggy Miller, legislative representative of the Consumer Federation of America in Washington, DC.

Ms. Brown, go right ahead.

STATEMENT OF JUDITH N. BROWN, MEMBER, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS, MINNEAPOLIS, MN

Ms. J. **Brown**. Thank you, Senator Proxmire. Good morning.

The American Association of Retired Persons, the AARP, appreciates this opportunity to comment on the basic banking and government check cashing provisions included in title IV of H.R. 5094.

AARP urges the members of the Senate Banking Committee to be certain that strong basic banking and government check cashing provisions like those contained in H.R. 5094 are included in any financial services legislation which passes this Congress. Passage of these provisions is essential to assure access to affordable banking services and a safe place to cash government checks for many low income and elderly persons.

The current language of H.R. 5094 represents minimum necessary basic banking and government check cashing provisions. Any further diminution of the present language of the bill would seriously imperil the effectiveness of these provisions.

Since many people need access to basic, no-frills banking accounts, AARP believes Congress should require financial institutions to provide individuals with access to a minimum level of banking services. H.R. 5094 assures the ready availability of no-frills banking accounts for many low and moderate income persons. AARP hopes that this committee will see to it that this provision is enacted in this Congress.

Given the reluctance of institutions to voluntarily meet the most basic banking needs for a large number of Americans, Congress must require financial institutions to cash government checks. The government check cashing provision contained in H.R. 5094 is a reasonable solution.

While H.R. 5094 government check cashing provisions extend to any Federal, State, or local government check, AARP is very concerned about attempts to limit the availability of this privilege to very narrowly defined categories of government checks.

This troubling provision is included in the most recent working draft of a government check cashing proposal on the Senate side. We see no valid reason to exclude government disability, veterans' retirement, including railroad retirement, State pension and teachers' retirement benefits from coverage under the check cashing provision. All these people deserve the same place to cash their government checks at reasonable cost.

AARP OPPOSES REQUIREMENT FOR DIRECT DEPOSIT

AARP opposes attempts to require the direct deposit of funds under the basic banking or government check cashing provisions. We oppose mandated direct deposit as a solution to the problem for the following reasons:

Many older Americans are reluctant to use direct deposit. For example, only 47 percent of Social Security beneficiaries currently use direct deposit. Acceptance of direct deposit is lowest among the low income population.

Consumers are experiencing tremendous difficulty in resolving direct deposit problems. Some Social Security beneficiaries have had to forego access to their Social Security funds for 4 to 6 months while attempting to retrieve their misdirected deposits.

I have had personal experience with this when I moved my elderly parents from New Jersey to Minnesota and tried to change which bank they had a direct deposit in. I believe that I am literate and able, and it took me over three months to make that change.

Many States expressly prohibit the direct use of direct deposit for public assistance checks.

While AARP actively encourages its members to utilize direct deposit services, we strongly believe that this decision rests with individual consumers rather than having it directly mandated as a precondition for services.

AARP therefore views sole recourse to direct deposit as a totally unacceptable solution to the basic banking account and government check cashing provisions. We urge you to assure access to essential banking services by supporting the basic banking and government check cashing provisions presently contained in H.R. 5094.

Thank you for this opportunity to participate.

[The complete prepared statement of Judith N. Brown follows:]

from the only effective CRA lever for encouragement -- action on applications.

However, if public disclosure of CRA evaluations does ultimately result in CRA evaluations and ratings that have more legitimacy -- a possibility, but by no means a good wager -- then community groups will have a strong incentive to submit comments prior to an evaluation, rather than waiting until an application has been filed. The burden of influencing a CRA evaluation and rating will become much greater after it is completed and made public, given the natural inclination of agencies to defend their public decisions. The only effective way to encourage community groups to comment on CRA performance during CRA examinations and evaluations is for the agencies to improve the legitimacy of their evaluations and ratings to the point where community groups perceive that they have a sufficient stake in the outcome of the evaluations to warrant the investment of scarce resources in commenting on evaluations. Any attempt to achieve this goal by imposing a penalty on groups that fail to comment will not accomplish its legitimate purpose, but will have a definite chilling effect on public participation in CRA implementation.

Moreover, authority to discount CRA protests would provide the agencies -- whose CRA implementation has been less than enthusiastic -- with a potent and inevitably arbitrary weapon to discourage CRA protests. The only possible situation in which discounting might have some legitimacy would be a situation in which a community group had (1) compiled and prepared extensive information on a bank's CRA performance, (2) learned that the bank would file an application in the immediate future, and (3) decided not to submit the information in a pending CRA evaluation so as to be able to catch the bank off guard when it filled its application. However, in order for the FRB to confine use of the "discounting" power to such situations, it would have to investigate the records of community organizations and delve into their motives -- a totally unacceptable approach. As a practical matter, use of the discounting power would inevitably be arbitrary, undercutting legitimate protests and deterring future protests.

Finally, where CRA examinations and evaluations are conducted only at 6, 7, or 8 year intervals -- which is currently the case for many national banks -- many CRA evaluations will so outdated that it would be a waste of time and resources for community groups to comment on them. The absurdity of penalizing a community group for not commenting on a 7 year old CRA evaluation is obvious.

AARP

STATEMENT

OF

AMERICAN ASSOCIATION OF RETIRED PERSONS

ON

BASIC BANKING

AND

GOVERNMENT CHECK CASHING

PROVISIONS OF

H.R. 5094

THE FINANCIAL MODERNIZATION ACT OF 1988

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

September 9, 1988

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Introduction

The American Association of Retired Persons (AARP) appreciates this opportunity to comment on the consumer provisions included in Title IV of H.R. 5094, the Depository Institutions Act of 1988. We are pleased that the Senate Banking Committee is highlighting these important provisions through these hearings.

AARP supports H.R. 5094's consumer provisions--enhanced Community Reinvestment Act enforcement, branch closing notifications, basic bank account availability and government check cashing privileges. However, our comments today focus on H.R. 5094's basic banking and government check cashing provisions.

AARP urges the members of the Senate Banking Committee to make certain that strong basic banking and government check cashing provisions, like those contained in H.R. 5094, are included in any financial services legislation that passes this Congress. Passage of these provisions is essential to assure access to affordable banking services and a safe place to cash government checks for many low income and elderly persons.

The current language of H.R. 5094 represents minimum necessary basic banking and government check cashing protections. Any further diminution of the present language of H.R. 5094 would seriously imperil the effectiveness of these provisions.

Basic Banking Accounts

Today, consumers find themselves having to "jump through hoops" just to get badly needed banking services. Access to necessary banking services is oftentimes difficult, sometimes next to impossible. Financial institutions now charge for services they used to offer for free, and have increased fees on other services. "Initial Deposits", "Monthly Fees", "ATM Charges", "Minimum Balances", "Fees For Return of Cancelled Checks", "Balance Inquiry Fees", "Overdraft Charges", as well as other terms and conditions are prevalent on many accounts.

Faced with this situation, consumers are having to budget for increased account costs, keep high balances, or give up bank accounts altogether. For many low and moderate income households, the increased costs of maintaining banking accounts have resulted in strained budgets. Others find it difficult to accumulate sufficient minimum balances while trying to meet necessary expenses like food, housing, and utilities.

The new or increased fees, coupled with more onerous account terms and conditions, have placed banking services beyond the reach of some low and moderate income, and elderly people. Thus, a number of people simply do not have bank accounts. For those without an account, paying bills becomes difficult; personal safety is jeopardized.

Since many people need access to basic, no-frills bank accounts, AARP believes Congress should require financial institutions to provide individuals with access to a minimal level of banking services.

Under H.R. 5094's basic banking provision, depository institutions would be required to offer checking accounts to individuals with no more than $1,000 on deposit. Fees and service charges for routine transactions could not exceed a minimal amount, as determined by the Federal Reserve Board. Minimum or opening balance requirements would be limited to $25 or less, with 10 withdrawals allowed per month. This account would not require the individual to exclusively use automated teller machines or other nonteller services, and would not require other account relationships. The institution would be required to provide either a monthly statement or a passbook detailing account activity.

Passage of the above language will assure the ready availability of basic, no-frills banking accounts for many low and moderate income people. AARP hopes the Senate Banking Committee will support the basic banking provision included in H.R. 5094.

Government Check Cashing

AARP is also concerned that many financial institutions have adopted "If you don't bank here, you can't cash here" practices. These policies even extend to government checks, with some institutions refusing to cash federal government checks (including Social Security, pension, retirement and disability benefits), state government checks (including pension, teacher retirement, and public assistance), and local government checks.

People without bank accounts are obviously having the greatest difficulty getting government checks cashed. However, even people with bank accounts are having trouble cashing government checks. Many financial institutions require their own account holders to maintain a balance sufficient to cover the amount of the check being cashed. Thus, if a customer, who is a retired schoolteacher, gets a $500 monthly teacher retirement check, some institutions will require her to have a $500 balance on deposit just to cash her teacher retirement check at her own bank.

Tragically, many of these are low income people who need all of their available funds to meet ordinary living expenses. They simply cannot afford to forego access to their money. Those who cannot get their government checks cashed at financial institutions are relegated to cashing their checks at expensive check cashing services or liquor stores.

Given the reluctance of institutions to voluntarily meet the most basic of banking needs for a large number of Americans, Congress must require financial institutions to cash government checks. The government check cashing provision contained in H.R. 5094 is a reasonable solution. Under this provision, financial institutions must make government check cashing services available in its basic banking account. Institutions would be required to cash federal, state, and local government checks in amounts of $1,500 or less. Institutions would be allowed to assess up to a $2 charge for cashing government checks, and would only be required to cash local government checks issued within their own state.

H.R. 5094's government check cashing provision is a reasonable compromise that addresses industry concerns while maintaining needed consumer protections. AARP hopes the Senate Banking Committee will support this important provision.

While H.R 5094's government check cashing provision extends to any federal, state, or local government check, AARP is very concerned about attempts to limit the availability of government check cashing privileges to very narrowly defined categories of government checks. This troubling provision is included in the most recent working draft of a government check cashing proposal on the Senate side, which would limit the government check cashing requirement to federal Social Security and home-state public assistance checks. We see no valid reason to exclude government disability, veterans, retirement (including railroad retirement), state pension and teacher retirement benefits from coverage under the government check cashing provision. All these people deserve a safe place to cash their government checks at a reasonable cost.

AARP Opposition To Mandating Direct Deposit

Since H.R. 5094 represents compromise language, AARP strongly opposes any further efforts to weaken its consumer provisions. Specifically, AARP opposes attempts to require the direct deposit of funds under the basic banking or government check cashing provisions. AARP opposes mandating direct deposit as a solution to these problems for the following reasons:

* Many older persons are reluctant to use direct deposit. In spite of aggressive efforts by the Treasury Department and financial institutions to encourage direct deposit, only 47% of Social Security beneficiaries currently use direct deposit. Thus, over 20 million Social Security beneficiaries do not use direct deposit;

The CHAIRMAN. Thank you very much, Ms. Brown.

Our final witness is Peggy Miller, legislative representative of the Consumer Federation of America.

Go right ahead.

STATEMENT OF PEGGY MILLER, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Ms. MILLER. I will keep my comments brief, Mr. Chairman. I hope my testimony will be included in the record.

The CHAIRMAN. It will be printed in the record in full.

Ms. MILLER. It is a pleasure to be here today, and I first want to thank you for your long tenure of support. We are here asking for a final step before you go.

The powers expansion you have included in this bill is not something that the Consumer Federation of America has quarreled with. The assumptions under those powers expansions are assumptions we have not really gotten involved with. What we have asked for in return is balance. We have asked for balance in this whole situation so that the moderate income and the low income, who have been impacted by deregulation, would also get assistance.

We are here in terms of title IV of H.R. 5094, because title IV basically does bring about that balance, in our opinion. The reason it does so is that the provisions on the basic banking and the provisions on CRA effectively provide for the access and the credit problems that, since 1983 have really been highlighted.

CFA itself has come before this committee many times to talk about the rising fees. This year, since your markup in March, we feel there were additional facts that came out which brought the coalition together to fight very strongly on the House side, I think even more so than ever before.

Those facts on the CRA have been pointed out already. On the basic banking and check cashing, GAO walked in and testified that you had a fifth of the families in this country without accounts.

Consumers Union did a study just this March—that only recently came out—which highlighted that 40 percent of low income people don't have accounts.

Then all the statistics compiled on what was happening at check cashing, outlets. The exploitive nature of the entire situation brought us together in terms of realizing that if a bill of this magnitude was to move forward without a balance, we could not support it.

So we are coming before you because basically the bill that is on the House side is very well-drafted legislation. The check cashing provisions dealt with a number of the concerns that were brought up.

The banks—even yesterday it was again pointed out that there were concerns in terms of fraud. We think that the current legislation effectively addresses these.

In the House bill there were a number of additional considerations added at the final point—the 20-day check hold; the account relationship; three branches by consumer choice; the Feds are allowed to suspend checks; the study of costs; the tellers are able to refuse any fraudulent check. These sorts of things were all provided to address the banks' concerns regarding fraud. A long list.

We think that because of those concessions we have effectively addressed their concerns on that point.

The only other couple of points I want to bring up are—one that direct deposit was brought up yesterday. We have to support AARP's position. Statistics show that older people do not use direct deposits. We provided this committee with all the statistics in the past couple of months. We cannot support that, because it would basically mean that the automatic banking provisions would not be used.

Two voluntarism. The only other point that I want to stress very strongly is that Lifeline banking is not being taken care of. We only want to clarify the statistics because they have been used in terms of policy decisions.

LIFELINE BANKING

The banking industry claims that Lifeline banking is being provided by 52 percent of the banks. The problem with this statistic is simply that they are not including minimum balance, maintenance fees, and opening requirements. When you include all those things, many of those accounts they call basic bank accounts can be higher in cost, according to GAO even, than the current standard account.

So, our findings in our fee survey and GAO's findings were that only 15 percent of the banks actually offer Lifeline accounts.

So, overall, we have a package that was well drafted, the Lifeline banking and check-cashing. They were folded into an account relationship.

We have dealt with the banks' concerns. We are offering them a fee of $2 on checks.

Supermarkets did come up with a study which showed that they did a very thorough study of their own check-cashing situation, and they were able to comprise that it cost 42 cents for them to cash a check.

I think that the $2 that we have allowed the banks is ample.

And on the Lifeline banking, the only final point I did want to make is that our only concern within this language that we would like the Senate side, hopefully, to help address in conference is that the fee was provided for the Feds to establish and the language, the statutory language, was not very clear.

We are concerned that the functional cost analysis approach possibly might be used by the Federal Reserve Board to determine this fee. That has not been shown to be an adequate analysis for fee structures.

We would ask that if it be left in the hands of the Fed—we would prefer a set fee taken back into the hands of Congress to be evaluated every couple of years—but if it is to be left in the hands of the Fed, basically you would ask them to do a time study such as was done for the supermarkets to basically evaluate so that you will be dealing with facts rather than subjectivity. Otherwise, we support this.

We think that basically what we have in title IV is an excellent package. It is a landmark package, and I think that if the committee was to move this, that the Senator could leave his long tenure pointing to a final, very excellent bill.

[The complete prepared statement of Peggy Miller follows:]

- Acceptance of direct deposit is lowest among the low income population. According to Treasury Department statistics, only 28% of Social Security Disability payments are directly deposited; only 14% of Supplemental Security Income benefits are directly deposited. Federal Reserve Board figures indicate that only 10% of families with bank accounts whose annual incomes are less than $10,000 use direct deposit; and
- Consumers are experiencing tremendous difficulty in resolving direct deposit problems. Some Social Security beneficiaries have had to forego access to their Social Security funds for 4 - 6 months while attempting to retrieve their mis-directed deposits;
- Many states, to monitor compliance with program requirements and deter fraud, expressly prohibit the use of direct deposit for public assistance checks.

As the result of the tremendous infusion of cash each month under a mandated direct deposit system, banks have the potential for reaping huge profits by investing funds before they are withdrawn from customers' accounts. With over $18 billion a month paid in Social Security (OASDI) benefits, the potential industry "float" from the direct deposit of Social Security benefits alone could be between $63 to $132 million a year. This windfall would obviously be much greater if all recurring federal payments were subjected to a direct deposit requirement.

While AARP actively encourages its members to utilize direct deposit services, we strongly believe this decision rests with individual consumers, rather than having direct deposit mandated as a necessary precondition for services. AARP, therefore, views sole recourse to direct deposit as a totally unacceptable solution to the basic banking account and government check cashing problems.

Conclusion

AARP believes financial institutions have an obligation to all income groups, including low and moderate income consumers. This is particularly true considering pronouncements of community benefits contained in charters, access to discounted federal funds, federal deposit insurance, and congressional consideration of the most far-reaching financial services restructuring legislation in recent history.

In the current financial services restructuring debate , the banking industry has been vigorously fighting competition while trying to expand areas of permissible activities. Ironically, the industry has failed to provide basic banking services, refuses to concede any obligations to consumers, and steadfastly opposes any requirements for services.

AARP urges you to assure access to essential banking services to low income consumers in your state by supporting the basic banking and government check cashing provisions presently contained in H.R. 5094.

Thank you for this opportunity to participate.

Consumer Federation of America

Testimony of
PEGGY MILLER
CONSUMER FEDERATION OF AMERICA

Before the
Banking Committee
U.S. Senate

on
TITLE IV OF H.R. 5094
September 9, 1988

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Mr. Chairman, Members of the Committee, I am here today to speak of those provisions in Title IV of H.R. 5094 which address issues not addressed or addressed substantially differently by the Senate Banking Deregulation Bill, S. 1886. Since the previous panel summarized the Community Reinvestment Act provisions in Title IV, I will speak mainly about the financial service account provisions that deal with government check cashing and basic banking issues, and I will state our overall position on the entire Title IV.

Mr. Chairman, Members, as you well know the Consumer Federation of America (CFA) is an organization comprised of over 240 organizations that represent over 50 million Americans. Financial service issues have been a key portion of CFA's legislative agenda for many years. This has been so because our members have continued to express deep concern over the lack of access to banking services and credit, as well as the need for better information on newly developed, complex products.

Since deregulation began, fees for banking services have risen, and high profit margin products as well as interstate expansion have captured banks' investment interest and capital, resulting in reduction of low cost accounts, services and individual or community credit.

We do not quarrel with the arguments that led to the decision for deregulation: that other non-regulated businesses were drawing off the "cream of the crop" through mutual fund accounts during the late 1970's, and so banks needed more flexibility to compete. We have not tried to intercede in this Committee's efforts to expand the powers of banks to enable them to compete in this fast paced financial service world.

We have asked for one thing in return for deregulation of the banking world: balance.

o Balance, to ensure that less financially active consumers, lower income consumers, can participate in the banking system through affordable, available small checking and savings accounts and loans for housing, education, and transportation.

o Balance, to allow for the proper disclosure of clear information, so that all consumers can at least make reasonable, educated decisions regarding the purchase of new, complex products.

o Balance, to provide our communities with the ability to thrive through reasonable access to the capital necessary to develop small businesses and housing for their neighborhoods.

Title IV of H.R. 5094 provides this necessary balance. It includes similar provisions to the excellent work performed by this Committee on disclosure and contractual needs related to savings and home equity loans, but it goes further.

If enacted into law, Title IV would ensure that lower incom persons would have access to low cost checking accounts so they could more easily and affordably pay their bills, and to check cashing services for a reasonable fee. It would accomplish this by requiring that banks establish a basic financial services account which offers lifeline banking and check cashing services It assists communities both by strengthening CRA to ensure that credit is made available for necessary small business developmen and housing projects and by giving communities time to plan alternatives when bank branches are to be closed.

NEED FOR BASIC BANKING, GOVERNMENT CHECK CASHING, AND IMPROVED CRA ENFORCEMENT:

Since this Committee marked up S. 1886 in March, additional information has been presented before the House and the Senate i testimony which documented the increased need for low cost acces to account and check cashing services and for credit.

o The General Accounting Office (GAO) summary report on check cashing revealed a startling fact: that almost one-fifth o the families in this country do not have bank accounts at all. Prior to this study, the only statistics available were Federal Reserve statistics showing that about 10% of the families did n have bank accounts.

o At the same time, a Consumer's Union study revealed that 40% of low income people in California (under $20,000 in annual income) do not have bank accounts and they are often charged as much as 6% of the face value for cashing government checks and 10% for purchasing money orders at check cashing outlets.

o The New Jersey study documented that consumers were bein charged up to 500% more than the regulated amount to cash their checks at check cashing outlets on one out of every two checks, exploitive prices at liquor and food stores, and were being forced to travel long distances just to cash a check.

o CFA's fifth annual national bank fee survey, released th year in June, showed that, once again, three-quarters of the banks in this country were continuing to refuse to cash government checks or to offer a basic account of eight checks f less than $3. The survey also showed that basic fees rose again totalling more than a 56% fee increase on NOW accounts over fiv years and a 20% increase on standard checking accounts over fiv years.

o Information on the lack of credit in Atlanta and Detroit was related to the unwillingness of banks in those cities to invest in certain communities, or in the local community in general. This information documented the continuing critical ne for improved community reinvestment laws and for strengthened enforcement of these laws.

There has been some debate over the validity of statistics on the availability of basic bank accounts. The American Bankers Association (ABA) contends that a high percentage of banks -- 52% according to one recent press release, 63% according to other statements -- already offer basic accounts. Therefore, they project that need has been addressed for that particular service.

I would like to clarify why the ABA's statistics are so different from CFA's or the GAO's statistics, both of which contend that the availability of basic bank accounts is closer to 15-20% on a national level.

The problem is that, when ABA compiled the information concerning basic accounts, the basic account was largely undefined. When one reviews the 1987 Retail Deposit Services Report, published by the ABA, the source from which the ABA information was taken, the situation clarifies itself: yes, 63.2% of banks offer "absolutely free checking," but those accounts still often have minimum opening balances of at least $100, have maintenance fees of at least $3-4, have minimum balance requirements of $200 on average, and can have additional fees for ATM use, account transfers, and other bank services. These additional requirements and fees can turn a basic bank account into an account that is more costly than a regular checking account, according to GAO and CFA research.

Therefore, the need for basic accounts is there, since only about 20% of the banks in this country offer truly low cost basic bank accounts, and one-fifth of all American families cannot currently afford accounts.

We commend the Committee for the work they did on Truth-in-Savings and Home Equity Loans, but such provisions address needs for information and product safety for average and higher income consumers.

The needs of lower income consumers, many of whom have no savings account at all or ever hope to own their own home, are not met by these provisions. Their problems are different. They need to be able to cash a check and pay their bills in a manner that is safe and reasonably priced.

As I stated before, allowing banks new powers on top of the deregulation that has occurred already -- deregulation which has directly caused fees to increase in a way that makes accounts unaffordable to many people -- needs to be balanced with services for those with less income. Balance is necessary to produce a fair, a just, a workable system for all, and the provisions in Title IV of H.R. 5094 are an attempt to strike that balance.

We realize that this Committee was not privy to many of the facts that came out this year until after S. 1886 was marked up. But now that you are aware of those facts, we ask you to reassess the situation and move to support and include, in any final

deregulation bill, the provisions in Title IV of H.R. 5094
were not addressed in S. 1886.

Since this bill portends to be historic, let us make i
truly historic and address both the banks' needs to provide
products for its higher income consumers and the banks' nee
provide low cost products for its lower income consumers.

Regrettably, the latter provision requires a mandate.
since fees were shown to be rising dramatically in 1983 and
due to deregulation of interest payment levels, banks have
asking for the freedom to use a voluntary approach to corre
problems of rising costs for lower income people. This volu
approach has not worked, fees continue to rise, and many lo
income people are no longer in the banking system.

It is time to act. Your help and support is needed to address this grievous situation.

SUMMARY OF THE DECISIONS THAT LED TO THE FINAL LANGUAGE IN H.R 5094's TITLE IV PROVISIONS ON LIFELINE BANKING AND GOVERNMENT CHECK CASHING:

The House bill went through many stages on government
cashing and lifeline banking legislation. The original comm
print contained free government check cashing provisions, bu
lifeline banking provisions that were not clear or consiste
with the needs for improved requirements.

At that time, the House Select Committee on Aging held
hearings on basic banking, government check cashing, and
community reinvestment. From those hearings and with the su
of many Members on the Banking Committee, new legislation w
drafted which addressed these issues in a compromise manner
AARP, and ACORN, as well as many other consumer organizatio
assisted in the drafting stages.

I) Government Check Cashing:

In terms of government check cashing, the banking indu
main concerns were cost, fraud, check size limit, and proble
identifying out-of-state locally issued checks. Consumers
concerns included retaining a clear, reasonable fee, avoidi
discriminatory practices such as check type limitations or
financially related i.d. requirements, providing for public
notice of the service's availability, and avoiding procedur
complexities that would be perceived as so onerous they wou
seriously impact the use of the service by the low-income
audience being represented.

At that time, the Senate Banking Committee staff was
floating a check cashing legislative proposal which explored

direct deposit and severe check type limitation approach to address fraud concerns of the bank. This proposal is absolutely unacceptable for the reasons just listed.

Direct deposit has been shown through Federal Reserve studies as well as Treasury Department results to be virtually unused by low income people, as ATM is unused. Clearly, such an approach is useless if the target audience has already been shown not to take advantage of such a system. There is no reason to accept only a chosen few types of checks and exclude a low income government check issued to a veteran, to a retired railroad worker, or to a retired school teacher. The House Banking Committee rejected both direct deposit and check type limitation approaches for government check cashing for these reasons.

Initially, the compromise legislation that appeared in the Committee Print used for markup purposes addressed both sides' concerns by setting a maximum fee of $2 to cover banks' costs, including fraud, by limiting the size of check to $3000,(no one wanted to go lower since there are veterans on 100% disability who receive checks of $2700 or more each month) and by excluding out-of-state, locally issued checks.

The final language on government check cashing in H.R. 5094, Title IV, contains many additional bank protections. In the final hours of the House Banking Committee markup the banks demanded that the check cashing service be handled under an account relationship. They contended that this would provide them with a customer relationship which, along with their other demands that were subsequently met, would reduce the likelihood of fraud. These other legislative demands of the banking industry which were included in the final language were:

o the authority to require, if they chose, an initial 20-calendar-day account hold upon opening the account;

o a check size limit of $1500;

o limitation of the check cashing activity to three branches of the customer's choice;

o authorization of the Federal Reserve Board to suspend the cashing of a check type when a fraudulent scheme related to that check type occurs;

o authorization of the Federal Reserve Board to conduct a study of the costs of fraud and whether such costs were higher than the fee established and report such findings to Congress within 18 months of the date of enactment;

o ability for any bank to refuse to cash a check if the check or i.d. appear fraudulent or in any way tampered with;

o authorization of the Federal Reserve Board to conduct
study of the feasibility and desirability of direct deposit o
all U.S. Government Entitlement checks, and to report the
findings within 90 days of the enactment of this act.

Though we do not believe that these provisions were
necessary -- since the banks had already received a maximum f
level far above check cashing costs, a reasonable check size
limit, and the exclusion of out-of-state, local checks -- we
not think that they preclude the check cashing service from b
effective in reaching the target audience of lower income pe
and therefore we support that portion of the legislation in

There were other concerns regarding the burden such chec
cashing activities might place on banks currently located in
income areas which were brought up during markup. These conc
were not deemed to have enough evidence since there was coun
evidence showing that banks that currently offer check cashi
services in low income areas have had little problems adjust
to the heavy activity associated with the offering of this
service. California First, a large bank in California which
just recently merged with First Union, offers check cashing
services in all of its 135 branches, many which are located
low income areas. They told CFA in a recent survey that they
heavy use of this service for social security checks, milita
checks, and AFDC checks, as well as other types, and that th
flow of people using the service is heavy on the days the ch
are received, but that they have been able to cope with the
problems.

Since this check cashing service will now be offered by
banks if it becomes law, this will spread out activity far m
so that traffic should not be too heavy in any single bank.
Furthermore, the fee far exceeds costs, so these people shou
looked on as customers paying for a service.

II) Lifeline Banking:

Banking industry concerns on lifeline banking legislati
mainly were to ensure that the fee reflects their costs; tha
accounts' audience be restricted to those who are truly low
income by restricting the total amount allowed on deposit in
depository institution to $1000 and by restricting the
withdrawals to ten; and that the i.d. requirements be thorou
Consumer concerns were to eliminate discriminatory requireme
such as i.d. related to income, age requirements, or ATM sol
requirements; to ensure that the total maintenance and any
service fees related to the account was low, low being defin
around $2.50 for maintenance, including the monthly statemen
transactions including ten withdrawals, balance inquiries, a
deposits; consumers felt that fees of no more than $5 should
exist for overdrafts and bounced checks. Consumer concerns a
included the need for restraints on the opening and minimal
balance requirements to no more than $25, the need for publi

notification, and the need for civil liability clauses.

Initially, the compromise language drafted for the Committee Print used in markup included language reflecting these concerns, stipulating that the fee should reflect these low levels and be set by the Federal Reserve Board. During markup, the banking industry pushed for two additional provisions, stating that the basic transaction service accounts could be closed if three overdrafts occurred within six months or if there was a pattern of fraudulent activity involving the account. These provisions were included. No other amendments were included during markup, except to fold this section in with the government check cashing section.

SUMMARY OF SUBTITLE C OF H.R. 5094'S TITLE IV -- ACCESS TO FINANCIAL SERVICES:

Specifically, the language in this section of H.R. 5094 requires all depository institutions to offer a new account, which is to be called a basic financial services account. This account would offer two services, either one or both of which could be chosen by the consumer registering for the account.

The Federal Reserve Board is authorized to prescribe the account registration requirements. These requirements shall include: that registration can occur at all bank offices, not including purely administration offices, and that the application should be a simple procedure requiring, if the Board deems it necessary, a photo i.d., a signature, a name and address, date of birth and other reasonable information requirements. The customer would be provided a copy of this registration, which he/she could use when cashing a check at any one of three chosen branches. The i.d. requirements would be prohibited from including any stipulations that are discriminatory for low income persons, including i.d. related to income or employment.

CFA would like to point out that at markup on the House side, it was clarified that the intent of this portion of the language was to keep the registration as simple as any other account opening at the bank.

At the time of registration the customer would select which services they chose to use, either the basic transaction services or the government check cashing services, or both.

A) Customers who select the check cashing service only would pay no more than the $2 fee per check cashed. The bank could choose to place up to a 20-day hold on the account for purposes of verifying the idenfication. If no hold were placed, the customer would be able to cash up to a $1500 check that same day. The customer would choose three branches at which to cash their checks in the future, and the bank would send a copy of the registration form to each of these branches.

The **Chairman**. Thank you, Ms. Miller.

Ms. Miller, is it your position that check-cashing and Lifeline services should be provided at-cost, or should the banks be required to offer these services at less than cost?

Ms. **Miller**. It was a difficult decision to move to a position of at-cost. But overall, we decided that for the purposes of bringing better access to low-income people, that moving it to an at-cost was acceptable. So, we supported at-cost.

FRAUD LOSSES

The **Chairman**. Let me ask you then, are fraud losses a legitimate cost that should be recovered in the fees charged for check-cashing?

Ms. **Miller**. Yes. We think that fraud losses—there has been extensive meetings within the staff with your committee and most of the groups. Fraud losses were determined—on U.S. Treasury checks—by GAO to be about 10 cents a check. We think that the $2 on check-cashing deals with that fee amply.

The **Chairman**. What if fraud losses in some communities exceed the $2 cap. Should there be some method to allow banks to break if fraud losses are higher than expected?

Ms. **Miller**. There are two approaches to that. One is already in the legislation. There is a study that is being required of the entire impact of this provision on fraud that will have to be reported back to the Congress within 18 months of enactment of this act, evaluating whether this has had any substantial impact.

The **Chairman**. What happens in the meanwhile, in the 18 months? Would the $2 limit not apply for 18 months?

Ms. **Miller**. The $2 limit would apply immediately.

The **Chairman**. Then if you have fraud loss exceeding it, the banks would have to incur a loss during that first 18 months, is that right?

Ms. **Miller**. We would be willing to work with the committee in terms of losses either within the Lifeline fee structure, within the check-cashing fee structure, from the standpoint that there are different approaches one could take here. You could have it by bank application. There are regional approaches. We would be willing to work with the committee in terms of report language that would deal with excessive situations.

The **Chairman**. Did you approve or disapprove discretion for the Fed to modify the $2 limit if the bank could show that during this 18 month period their losses exceeded that $2?

Ms. **Miller**. As I said, we would be willing to work with the committee in terms of the report language. If there was factual data provided along the lines where a study had been performed that I have just referred to show that this is an excessive problem, we would be willing to work with the committee in terms of language to that effect.

The **Chairman**. Ms. Brown, you complained about banks charging customers for services once provided for free. But I don't hear complaints about banks competing to pay you higher rates on your savings. It seems to me that these developments are two sides of the same coin. With the shift from cross-subsidized bank services to explicit pricing no longer can banks make huge profits from low-interest savings and no-interest checking accounts.

They don't have that automatic profit available for subsidizing other bank services. What is your response to that?

Mr. J. **Brown**. My response to that is that I think that the need for our communities to have opportunity to have banking services continues. Many of the older people in our country are people who have used those bank services for many, many years, and the banks have made a great deal of money on that populace for a long time. And I think it is not unwise to ask the banks to offer banking services at a break-even point.

The **Chairman**. Let me interrupt to say that these are the same groups who picketed the Congress to lift the limit on the interest that banks can pay—and succeeded.

So, it's pretty hard under those circumstances to argue that the elderly deserve all the services they had before, which were made possible, in part, because there was a limit on paying interest.

Mr. J. **Brown**. It is my understanding that the legislation, as proposed, is at a break-even point for the banks and the banks will not be losing money on these programs. Again——

The **Chairman**. I am going to ask Mr. McLean to follow up on that. He has a question.

Mr. **McLean**. The question was whether the AARP supports or agrees with the CFA that the service should be provided at-cost and not at a subsidized premium.

Mr. J. **Brown**. I believe it is our position that the proposal should be at-cost.

The **Chairman**. Thank you.

The Consumers Bankers Association testified yesterday that a depository institution makes a decision on whether to offer a Lifeline or perhaps a check-cashing account by considering a number of factors that are unique to that institution. For some banks, for example, the risk of fraud is significant while for other institutions it would be minimal. Because there are a great number of institutional factors that must be taken into account, it is impractical and indeed irresponsible to require that all institutions provide a uniform product or service.

MANDATORY UNIFORM BANKING SERVICES

Do you think that this argument against mandatory uniform banking services has any merit?

Ms. **Miller**. No. Not any longer, for a couple of reasons. I think the fraud argument—though I understand their concern always as to fraud—has been overstated as it relates to the low-income situation.

We did a study where we called 19 banks that actually do cash checks right now. They do it in low-income neighborhoods. They have a high volume. When we asked them questions about were they really incurring problems with fraud, they said it was negligible.

One bank did report they initially had some fraud problems, but when they trained their tellers to look for signatures carefully, that fraud was virtually eliminated.

The other point is that check-cashing outlets themselves, the only statistics I was able to find were in a couple of press articles back in 1985, that they basically were showing a lower check-bounce rate than banks.

And the only reason I point that out is that I don't think there is any information—and we really looked for it as we worked this year, because fraud is constantly being raised—to substantiate this fraud concern whatsoever.

And so between that fact and that we have given the banks 5 years to use the voluntary approach, which has been absolutely ineffective, and from the States that have moved into a check-cashing approach where there has been no problem—Connecticut came in and they are basically saying there is no problem.

Even GAO said this fraud issue has been vastly overstated.

I think that a mandatory approach is the only way.

The CHAIRMAN. Thank you.

Ms. Brown, you make a point of opposing any effort to mandate direct deposit. You pointed out how few Social Security beneficiaries use direct deposit. Yet, where direct deposit has been mandated, the satisfaction rates have been very high.

For example, user satisfaction rates in direct-deposit systems for public assistance programs in New York, Pennsylvania, Minnesota are 90 percent, 80 percent, and 83 percent, respectively.

How do you account for those high ratios?

Ms. BROWN. Three. I can't answer that directly. I do know that AARP has worked hard with some other groups to try to encourage members of AARP to use direct deposit. And it just does not appear that all of our members wish to use it.

I think also part of the problem is the difficulty sometimes in getting direct deposits set up will cause the recipient to be without funds for two or three months and many poor and older people simply cannot be without their own funds.

The CHAIRMAN. Let me just interrupt to say isn't this a nominal satisfaction rate? People are satisfied, 80 to 90 percent satisfied. That is remarkable.

Mr. J. BROWN. Yes, it is. What we are saying is we are telling people who for whatever reason have not chosen to do direct deposit, that because everybody who uses it is satisfied, that they have to give up an individual right. And we still believe that that should be a right of a person to determine whether they want to use that or not.

I do think that the problem—we have had letters, many, many letters, where our members have told us that they have tried to go on direct deposit and they have been without funds for 2, 3, and 4 months, and they cannot afford that.

So, I think it is unfair to put that upon an individual.

The CHAIRMAN. Ms. Miller, do you want to comment?

Ms. MILLER. Just briefly. Your point is accurate. We also have some interest in this whole issue of mandated direct deposit. We feel that the country is a step at a time moving in the direction of direct deposit. We did not feel that to move to a mandated direct deposit at this time was a good idea.

When you move into the national level there have been some enormous problems that have been associated with direct deposit, as AARP has experienced.

That was why in the language there is a study that has to be performed analyzing this whole question more thoroughly because I think the points should be looked at.

The CHAIRMAN. Ms. Brown, the AARP's credit union is already one of the largest in the country. Do you agree that the CRA requirements should apply to credit unions as they do to banks?

Mr. J. BROWN. Probably, yes.

The CHAIRMAN. Probably? Why not?

Mr. J. BROWN. I would have to say that AARP's credit union, one of our main purposes in establishing the credit union was to provide opportunities for older people and poorer people to have access to lower-rate-interest loans and services that credit unions can provide at a more reasonable price and better service.

The CHAIRMAN. I would think that the CRA requirements should apply to them. They are increasingly important. We are proud of credit unions' ability. The international headquarters is in Madison, WI, and they are very big in our State, and they perform, of course, a superb service.

But it would seem to me that they should be subject to the same CRA requirements every other financial institution is.

Mr. J. BROWN. AARP would hope that the credit union would never have to have the need to be responsible by law, that we would be responsible ourselves.

The CHAIRMAN. Ms. Miller, under the House law, basic banking account couldn't be terminated unless there is a pattern of fraud established. Isn't this a level of immunity from antifraud law greater than that enjoyed by the average account holder? Shouldn't the same standards apply? Why do you have to have a pattern of fraud?

Ms. MILLER. In order to terminate the account; why is that language in there?

The CHAIRMAN. That's right.

Ms. MILLER. Right at the last minute in the markup the banks were looking for any language that would help soften that from the standpoint of their fraud concerns. We acquiesced to that language because we have no difficulties with it because we don't in any way perceive low-income accounts as having any more of a fraudulent pattern than any other account.

Yes, I think if you have language of this nature, it should pertain overall. But we were willing to accept that if that addressed their concerns.

The CHAIRMAN. I want to thank all of you witnesses. You certainly were highly competent and responsive, and we are very grateful to you.

The committee will stand adjourned.

[Whereupon, at 11:35 a.m., the committee was adjourned.]

[Additional material supplied for the record follows:]

When presenting a check for cashing purposes, the customer would have to present a copy of the registration form, a photo identification card, and their account number.

CFA would like to point out that the photo i.d. here is to be as that presribed by the Federal Reserve Board. We conducted some research and found that all state motor vehicle departments offer a service of providing a photo i.d. to anyone for a low cost. This is one possible mechanism for providing the required photo i.d.

Finally, any depository institutions would not have to cash any check presented by such a customer if they have reasonable cause to believe that the check is fraudulent or has been tampered with. We support this approach to restraining fraud, because many banks we have talked to that already offer check cashing services pointed out that their fraud problems were virtually eliminated when they trained their tellers to check signatures and examine the check closely. This human ability to detect fraud exists, and this language supports such judgement capacity.

B) A customer registering for the account who selects the basic transaction service would have to pay the low fees to be set by the Federal Reserve Board for the basic transaction service. This would cover a service that provides a basic account, including no less than ten withdrawals, and a monthly statement or passbook record of all transactions. Only those with a total of no more than $1000 on deposit in the bank could use this service. (This $1000 restriction and the ten-withdrawal limit were felt to be enough of a restriction on the account to eliminate any but lower income users.) The minimum opening and minimal balance could be no more than $25. No discriminatory requirements for using that service would be allowed, such as i.d. requirements related to income or employment, sole use of ATM, or age requirements.

The fee language in this section needs to be clarified, if possible, with additional language defining the term minimal amount more explicitly. The House report language did go on to clarify that the fee set by the Federal Reserve Board must take into consideration net processing costs but did not clarify just what other costs could be taken into consideration.

Our concern is that some such cost method as the functional cost analysis method used by the Federal Reserve Board might be used to determine the cost of these accounts, and the fee would not reflect reality. Since the entire purpose of these accounts is to establish a low cost basic account that is very limited, the fee which is established is absolutely critical. Our intent was to allow for a fee that was not inherently so low as to immediately cost the banks. We had been asking to have a fee of $2.50 set, since that fee seemed to be representative and is in fact higher than the fees of many banks that currently offer low cost accounts.

We ask that the Senate Committee endeavor to change this section to reflect a set fee, like the check cashing fee, or to provide far greater direction to the Federal Reserve to carry out an actual time study of the precise costs of operating a small account in order to determine actual costs, and that they submit this analysis in report form to the Congress.

Statistics on the actual costs of such accounts are scarce. In fact, the only statistics we have on banks' check processing costs are the ones that the ABA cited of 37 cents for cashing a check. I would like to point to a very thorough analysis of check cashing costs -- performed by the the Food Marketing Institute in 1984 for the supermarket industry -- which did include virtually all costs and revealed their costs to be 42 cents per check for cashing purposes.

This does not reflect the costs of a basic bank account, but it could be taken into account when the Federal Reserve Board explores fee setting.

CFA supports these provisions, and the entire Title IV as needed in any deregulation bill to balance the impacts of increasing fees and complexity of banking products.

We urge your support for including the new portions of Title IV in any final deregulation bill.

100TH CONGRESS
2D SESSION

H. R. 5094

[Report No. 100–822, Part I]

To strengthen the competitiveness and protect the safety and soundness of depository institutions, to provide additional benefits to and protections for consumers of financial services, to strengthen the enforcement authority of depository institutions regulatory agencies, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 26, 1988

Mr. ST GERMAIN introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

AUGUST 4, 1988

Reported with an amendment and referred to the Committee on Energy and Commerce, for a period ending not later than September 22, 1988, for consideration of such provisions of the bill and amendment as fall within the jurisdiction of that committee pursuant to clause 1(h), rule X, and to the Committee on the Judiciary, for a period ending not later than September 22, 1988, for consideration of such provisions of section 102(c) of the amendment recommended by the Committee on Banking, Finance and Urban Affairs as propose the addition of a new section 5(e) to the Bank Holding Company Act of 1956 and fall within the jurisdiction of the Committee on the Judiciary pursuant to clause 1(m)(16), rule X, and for consideration of such provisions of sections 203(a) and 608 of the amendment recommended by the Committee on Banking, Finance and Urban Affairs as propose criminal penalties and fall within the jurisdiction of the Committee on the Judiciary pursuant to clause 1(m)(1), rule X.

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on July 26, 1988]

TITLE IV—CONSUMER PROTECTION PROVISIONS

Subtitle A—Community Benefits

SEC. 401. SHORT TITLE.

This subtitle may be cited as the "Community Benefits Amendments of 1988".

SEC. 402. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress hereby finds the following:

(1) Under existing law, federally insured banks and thrift institutions have a continuing and affirmative obligation to help meet the credit needs of their local communities consistent with the safe and sound operations of depository institutions.

(2) The deregulation of depository institutions which continues to proceed in a number of areas, including deposit interest rate decontrol, technological innovation, interstate banking, expanded powers for depository institutions, and competition for depository institutions from other financial institutions, threatens to detach depository institutions from their local communities and reduce access to credit and deposit services for persons of moderate means, small businesses, small farms, low- and moderate-income neighborhoods, and areas experiencing slow economic growth.

(3) Stronger incentives are needed to encourage depository institutions to help meet the credit needs of their local communities consistent with the safe and sound operations of depository institutions.

(4) The Federal depository institutions regulatory agencies must improve their efforts to encourage depository institutions to help meet the credit needs of their local communities.

(5) Public participation significantly enhances the capability of the Federal depository institutions regulatory agencies to encourage depository institutions to help meet the credit needs of their local communities.

(b) PURPOSES.—It is the purpose of this subtitle to—

(1) require depository institutions, and the holding companies of depository institutions, seeking approval for interstate expansion or additional powers to meet a higher community reinvestment standard;

(2) require the Federal depository institutions regulatory agencies to—

(A) establish more rigorous criteria for evaluating the performance of depository institutions in meeting the credit needs of their local communities consistent with the safe and sound operations of depository institutions; and

(B) systematically disclose to the public the standards and performance data which have been used by such agencies in evaluating the performance of depository institutions in meeting such credit needs; and

(3) encourage public participation in the regulatory process for evaluating the performance of depository institutions in meeting the credit needs of their local communities.

SEC. 403. AMENDMENTS TO THE BANK HOLDING COMPANY ACT OF 1956.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.) is amended by inserting after section 10 (as added by section 202 of this Act) the following new section:

"SEC. 11. COMMUNITY BENEFITS REQUIREMENTS.

"(a) MINIMUM COMMUNITY REINVESTMENT RATING REQUIRED FOR CERTAIN APPROVALS.—

"(1) IN GENERAL.—Unless the requirements of paragraph (2) are met, the Board shall not approve any of the following applications (for which the Board's approval is required) and shall disapprove any notice of any company's intention to engage in any of the following transactions or activities (for which the Board's approval is not required):

"(A) Any application under section 3(a) by—

"(i) any bank holding company to acquire control of another bank (other than a bank described in clause (i), (ii), (iii), or (iv) of subsection (f)(4)(A)) or bank holding company; or

"(ii) any bank (other than a bank described in any clause of subsection (f)(5)(A)) to acquire control of another bank (other than a bank described in clause (i), (ii), (iii), or (iv) of subsection (f)(4)(A)) or any bank holding company.

"(B) Any application by a bank holding company to engage in, or any notice by a bank holding company of such company's intention to engage in, (as the case may be) any activity (or to acquire the shares of any company engaged in any activity) described in any paragraph of section 4(c).

"(2) MINIMUM COMMUNITY REINVESTMENT RATING REQUIREMENTS.—The requirements of this paragraph are met if—

"(A) in the case of an application or notice described in subparagraph (A)(i) or (B) of para-

graph (1), the applying bank holding company has an imputed community reinvestment rating of 2 or better (as determined in accordance with subsection (f)); and

"(B) in the case of an application described in paragraph (1)(A)(ii), the applying bank has an community reinvestment rating of 2 or better (as determined under section 810 of the Community Reinvestment Act of 1977).

"(3) SPECIAL RULES FOR BANKS AND BHCS WITH ABOVE AVERAGE COMMUNITY REINVESTMENT RATINGS.—

"(A) EXCEPTION FOR CERTAIN APPLICATIONS.—Notwithstanding paragraph (1)(B), this section shall not apply with respect to any notice by a bank holding company described in paragraph (2)(A) of such company's intention to engage in any activity described in subsection (a) or (b) of §225.22 of title 12 of the Code of Federal Regulations (as in effect on the date of the enactment of the Depository Institutions Act of 1988).

"(B) WRITTEN FINDINGS WITHIN 60 DAYS IF NO HEARING IS HELD.—In the case of an application or notice described in subparagraph

(A)(i) or (B) of paragraph (1) by a bank holding company described in paragraph (2)(A) or an application described in paragraph (1)(A)(ii) by a bank described in paragraph (2)(B), if—

"(i) no comments are received under subsection (h)(1); or

"(ii) with respect to comments received, the Board determines that no substantial issue referred to in subsection (h)(2)(A) has been raised,

the Board shall issue a written finding which meets the requirement of subsection (h)(3) before the end of the 60-day period beginning on the later of the dates described in subparagraphs (A) and (B) of subsection (h)(1).

"(C) WRITTEN FINDINGS WITHIN 90 DAYS IF A HEARING IS HELD.—If a hearing is conducted under subsection (h)(2) in connection with an application or notice described in subparagraph (A)(i) or (B) of paragraph (1) by a bank holding company described in paragraph (2)(A) or an application described in paragraph (1)(A)(ii) by a bank described in paragraph (2)(B), the Board shall issue a written finding which meets the requirement of subsection (h)(3) before the end

of the 90-day period beginning on the later of the dates described in subparagraphs (A) and (B) of subsection (h)(1).

"(b) PRELIMINARY APPROVAL WITH REVIEW PERIOD IN CERTAIN OTHER CASES.—

"(1) PRELIMINARY APPROVAL.—Notwithstanding subsection (a), the Board may preliminarily approve an application described in such subsection if—

"(A) in the case of an application by—

"(i) a bank holding company, such bank holding company has an imputed community reinvestment rating of 3; or

"(ii) a bank, such bank has an community reinvestment rating of 3; and

"(B) the bank holding company or bank enters into such commitments as the Board may require, taking into account any public comments or testimony received under subsection (h), to take actions that will enable the bank holding company, including the resulting bank holding company in the case of an application by a bank, to receive the imputed community reinvestment rating described in subsection (a)(2)(A) before the end of the 2-year period beginning on the date of the preliminary approval of such application.

"(2) SPECIAL RULE IN CASE OF NOTICES.—In the case of a notice described in subsection (a)(1)(B) which is submitted by a bank holding company described in paragraph (1)(A) of this subsection, the Board may, notwithstanding subsection (a)(1), preliminarily approve the commencement of the activity or the acquisition (with respect to which such notice is submitted) if the bank holding company meets the requirements of paragraph (1)(B) of this subsection.

"(3) REVIEW.—At the end of the 180-day period beginning on the date the Board preliminarily approved—

"(A) an application described in subsection (a) pursuant to paragraph (1) of this subsection; or

"(B) a notice described in subsection (a)(1)(B) pursuant to paragraph (2) of this subsection,

the Board shall review the policies and programs adopted by the applying or the notifying bank holding company to implement the commitments described in paragraph (1)(B) of this subsection.

"(4) EXPIRATION OF PRELIMINARY APPROVAL; FINAL APPROVAL.—No preliminary approval by the Board under paragraph (1) or (2) of this subsection of

an application or notice described in subsection (a) shall be effective after the end of the 30-day period beginning at the end of the 180-day period described in paragraph (3) of this subsection unless the Board approves such application or notice in a final written approval issued before the end of such 30-day period.

"(5) CONDITION ON FINAL APPROVAL.—The Board may not approve an application or notice in a final written approval under paragraph (4) unless the Board determines, pursuant to the review under paragraph (3), that the policies and programs adopted by the applying or the notifying bank holding company to implement the commitments described in paragraph (1)(B) have a substantial likelihood of resulting in the fulfillment of such commitments.

"(6) PUBLIC HEARING.—At the end of the 2-year period described in paragraph (1), the Board shall hold a public hearing with respect to any bank holding company or bank which receives final approval under paragraph (5) at which interested community and consumer groups shall be given opportunity to testify concerning the bank holding company or bank's performance in fulfilling the commitments described in paragraph (1)(B).

"(7) APPROVAL ALLOWED FOR CERTAIN ACQUISITIONS INVOLVING BANKS WITH RATING OF LESS THAN 3.—Notwithstanding subsection (a) and subject to all the requirements of paragraphs (3) through (6) of this subsection, the Board may preliminarily approve, under paragraph (1) of this subsection, an application under section 3(a) of this Act (to which section 3(d) does not apply) by—

"(A) any bank with a community reinvestment rating of less than 3 for the acquisition of control of another bank; or

"(B) any bank holding company for the acquisition of control of any bank with a community reinvestment rating of less than 3,

if the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act) approves such acquisition and the acquiring bank or bank holding company enters into commitments described in paragraph (1)(B) of this subsection.

"(8) PRELIMINARY APPROVAL TREATED AS FINAL APPROVAL FOR CERTAIN PURPOSES.—A preliminary approval by the Board under paragraph (1) or (2) of this subsection of any application or notice shall be treated as—

"(A) a final order with respect to such application or notice for purposes of section 15 of this Act; and

"(B) a final approval with respect to such application or notice for purposes of section 16(b) of this Act.

"(c) BOARD DISAPPROVAL REQUIRED IF APPLICANT EXHIBITS CERTAIN PATTERNS OF ACTIVITY.—

"(1) IN GENERAL.—The Board shall not approve an application described in subsection (a)(1) and shall disapprove any notice described in such subsection if the applying or notifying bank holding company, or any bank or insured institution subsidiary of such company, or the applying bank has established a pattern of—

"(A) acquiring or chartering federally insured depository institutions in a manner that tends to exclude low- and moderate-income neighborhoods or equivalent areas; or

"(B) opening or closing deposit facilities within the service area of any bank or insured institution subsidiary, in the case of an applying or notifying bank holding company, or of the applying bank in a manner that tends to exclude low- and moderate-income neighborhoods or equivalent

areas, except that the closing of any deposit facility which the Board determines was occasioned by considerations relating to the safety and soundness of a depository institution shall not be taken into account for purposes of this paragraph.

"(2) RECONSIDERATION.—The Board may reconsider any application or notice described in paragraph (1) during the 90-day period following disapproval of such application or notice if the applying or notifying bank holding company, or the applying bank, submits a plan that the Board determines would reasonably be expected to improve services for low- and moderate-income persons and neighborhoods.

"(d) ADDITIONAL REQUIREMENT RELATING TO SECURITIES ACTIVITIES.—The Board shall not approve—

"(1) any application by a bank holding company to establish a qualified securities subsidiary;

"(2) any application under section 3(a) by any company which, at the time of application, is not a bank or bank holding company to acquire control of any bank; or

"(3) any application under section 3(a) by a bank holding company with a securities subsidiary to acquire an additional bank,

unless the applicant company enters into such commitments as the Board may require, taking into account any public comments or testimony received under subsection (h), to provide reasonable assurance that the proposed combination of banking and securities activities (if any) within the bank holding company structure following the approval of such application will not diminish the availability of credit and deposit services for low- and moderate-income persons or small businesses or within low- and moderate-income neighborhoods or equivalent areas.

"*(e)* ADDITIONAL REQUIREMENTS RELATING TO APPLICATIONS BY COMPANIES WHICH ARE NOT BANKS OR BHCS.—*The Board may not approve an application under section 3(a) by any company which, at the time of application, is not a bank or bank holding company to—*

"*(1) acquire a bank with a community reinvestment rating less favorable than 2 unless the company enters into such commitments as the Board may require, taking into account any public comments or testimony received under subsection (h), to take actions that will enable the bank to achieve a community reinvestment rating of 2 or better before the end of the 2-year period beginning on the date of the approval of such application; or*

"(2) acquire a bank with a community reinvestment rating of 1 or 2 unless the company enters into such commitments as the Board may require, taking into account any public comments or testimony received under subsection (h), to take actions that will enable the bank to maintain or improve such bank's community reinvestment rating.

"(f) IMPUTED COMMUNITY REINVESTMENT RATING.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the imputed community reinvestment rating for any bank holding company (for purposes of this section) is the community reinvestment rating assigned to the bank or insured institution subsidiary of such company with the least favorable community reinvestment rating.

"(2) SPECIAL RULE IN THE CASE OF A COMPANY WITH 5 OR MORE DEPOSITORY INSTITUTION SUBSIDIARIES IN 1 STATE.—In the case of any bank holding company which controls 5 or more bank or insured institution subsidiaries in 1 State, the imputed community reinvestment rating for such bank holding company (for purposes of this section) shall be 1 grade higher than the community reinvestment rating of the bank or insure institution subsidiary of such company

with the least favorable community reinvestment rating if—

"(A) the community reinvestment ratings of not less than 80 percent of all bank or insured institution subsidiaries of such company are equal to or greater than such imputed reinvestment rating; and

"(B) the community reinvestment rating of the largest bank or insured institution subsidiary of such company is equal to or greater than such imputed reinvestment rating.

"(3) SPECIAL RULE IN THE CASE OF A COMPANY WITH 5 OR MORE DEPOSITORY INSTITUTION SUBSIDIARIES IN MORE THAN 1 STATE.—In the case of any bank holding company which controls 5 or more bank or insured institution subsidiaries in more than 1 State, the imputed community reinvestment rating for such bank holding company (for purposes of this section) shall be 1 grade higher than the community reinvestment rating of the bank or insured institution subsidiary of such company with the least favorable community reinvestment rating if the total assets of such bank or insured institution, and the total assets of all other banks and insured institution subsidiaries of such bank holding company whose community reinvest-

ment ratings are the same as such bank or insured institution subsidiary, do not exceed, in the aggregate, 7.5 percent of the consolidated total assets of such bank holding company.

"(4) EXCLUSION OF CERTAIN DEPOSITORY INSTITUTIONS.—

"(A) IN GENERAL.—Subject to subparagraph (B), the community reinvestment ratings of the following depository institutions shall not be taken into account for purposes of determining the imputed community reinvestment rating for any bank holding company under paragraph (1):

"(i) Any institution described in any subparagraph of section 2(c)(2) of this Act.

"(ii) Any institution which—

"(I) serves solely as a correspondent bank, transfer agent, trust company, or clearing agent; and

"(II) does not extend credit to the public.

"(iii) Any bank or insured institution which was acquired by such bank holding company in an acquisition under section 13(f) of the Federal Deposit Insurance Act or section 408(m) of the National Housing

Act, during the 2-year period beginning on the date such acquisition is made.

"(iv) Any bank or insured institution with a CAMEL composite rating of 4 or less under the Uniform Financial Institutions Rating System (or an equivalent rating under a comparable system), or a similarly weakened bank or insured institution, which is acquired by such bank holding company, during the 2-year period beginning on the date such acquisition is made.

"(v) Any bank or insured institution which commences operations de novo, during the 2-year period beginning on the date such operations commence.

"(B) P*LAN.—Clauses (iii), (iv), and (v) of subparagraph (A) shall apply with respect to any bank holding company only if, within the 90-day period beginning on the date a depository institution described in any such clause is acquired or commences operations, such bank holding company submits a plan that the Board determines would reasonably be expected to enable such depository institution to receive a community reinvestment rating of 1 or 2 (as determined under*

section 810 of the Community Reinvestment Act of 1977).

"(C) TRANSITION RULE FOR CERTAIN ACQUISITIONS.—In the case of any depository institution described in clause (iii) or (iv) of subparagraph (A) which was acquired by any bank holding company after December 31, 1985, and before the date of the enactment of the Depository Institutions Act of 1988, the community reinvestment ratings of such depository institution shall not be taken into account for purposes of determining the imputed community reinvestment rating for such bank holding company under paragraph (1) during the 2-year period beginning on the date of the enactment of such Act if such bank holding company submits a plan described in subparagraph (B) before the end of the 90-day period beginning on the date of the enactment of such Act.

"(5) EXCLUSION OF CERTAIN AGRICULTURAL BANKS AND BANKS WITH ASSETS OF NOT MORE THAN $25,000,000.—

"(A) IN GENERAL.—The community reinvestment ratings of the following depository institutions shall not be taken into account for purposes of determining the imputed community rein-

vestment rating for any bank holding company under paragraph (1):

"(i) Any agricultural bank with assets of $50,000,000 or less.

"(ii) Any bank with assets of $25,000,000 or less.

"(B) AGRICULTURAL BANK DEFINED.—For purposes of subparagraph (A), the term 'agricultural bank' means any bank which has 25 percent or more of its loan assets in agricultural loans or real estate loans made by such institution to customers located in the market area served by such bank.

"(C) AGRICULTURAL LOAN DEFINED.—For purposes of subparagraph (A), the term 'agricultural loan' means—

"(i) any loan made to finance the production of agricultural products or livestock in the United States;

"(ii) any loan secured by farmland or farm machinery in the United States; and

"(iii) any other category of loans which the Board determines have been made for agricultural purposes.

"(g) NOTICE REQUIRED.—

"(1) Notice.—Any bank holding company, bank, or other company which submits an application or notice described in subsection (a)(1) or (e) to the Board shall publish notice of the submission of the application or notice, together with information concerning the proposed action, by publication in the manner prescribed in regulations prescribed by the Board as in effect on June 5, 1985.

"(2) Bulletins required.—The Board shall—

"(A) prepare a weekly bulletin listing the bank holding companies, banks, and other companies which have submitted applications or notices described in subsection (a)(1) since the last bulletin was prepared; and

"(B) shall mail such bulletin without charge to any person upon request.

"(h) Comments Required To Be Accepted and Considered; Written Findings.—

"(1) Opportunity for comment.—Before approving any application described in subsection (a)(1) or (e) or allowing any period for disapproval of a notice described in subsection (a)(1)(B) to expire without disapproval, the Board shall accept public com-

ments on the application or notice during a period of not less than 45 days beginning on the later of—

"(A) the date of the notice required pursuant to subsection (g)(1); or

"(B) the date on which the Board published the weekly bulletin required under subsection (g)(2) which contains the notice of such application or notice.

"(2) HEARING.—The Board may hold an informal hearing relating to any application or notice described in subsection (a)(1) or (e) at the request of any person who submitted comments under paragraph (1) with respect to such application or notice which, in the judgment of the Board, raises a substantial issue with respect to—

"(A) the performance of—

"(i) the applying or notifying bank holding company, or any bank or insured institution subsidiary of such holding company, or the applying bank; or

"(ii) in the case of an application described in subsection (e) by any company described in such subsection, the bank which such company proposes to acquire,

in serving local community credit needs; or

"(B) the adequacy of any commitment made by the applicant pursuant to subsection (b)(1)(B), (d), or (e).

"(3) WRITTEN FINDINGS.—Before approving any application described in subsection (a)(1) or (e) or allowing any period (which for purposes of this section may be extended in the manner provided in section 4(i)(5) for periods to which section applies) for disapproval of a notice described in subsection (a)(1)(B) to expire without disapproval, the Board shall prepare and make public a written finding with respect to each factor the Board is required to take into account in considering such application or notice, or in making any determination with respect to such application or notice, under this section.

"(i) PUBLIC AVAILABILITY OF COMMITMENTS.—Any commitment proposed or agreed to under subsection (b)(1)(B) or (e) by any bank holding company, bank, or other company in connection with an application or notice described in subsection (a)(1) or (e) shall be available to the public.

"(j) CONTINUING ENFORCEMENT.—If—

"(1) at any time after any bank holding company receives final approval of an application under subsection (a), (b)(4), or (e) (including any bank or other company which becomes a bank holding company by

reason of such approval) or any bank holding company commences any activity or acquisition the notice with respect to which was not disapproved by the Board pursuant to subsection (a)—

"(A) such bank holding company receives an imputed community reinvestment rating of 4 or 5; or

"(B) such bank holding company violates the terms of any commitment made by such company under subsection (b)(1), (d), or (e); and

"(2) before the end of the 18-month period beginning on the date such company received the community reinvestment rating described in paragraph (1)(A) or committed the violation described in paragraph (1)(B), such company has not—

"(A) received an imputed community reinvestment rating of 3 or better; or

"(B) come into compliance with the terms of such company's commitments,

the failure of such bank holding company to maintain an imputed community reinvestment rating of 3 or better or to remain in compliance with the terms of such company's commitments shall be treated as a violation of this Act by such company for purposes of section 14(b) of this Act.

"(k) ***Definitions.****—For purposes of this section—*

"(1) COMMUNITY REINVESTMENT RATING.—The term 'community reinvestment rating' means, with regard to a bank, the numerical rating assigned to such bank pursuant to section 810 of the Community Reinvestment Act of 1977 or subsection (f)(3) of this section.

"(2) LOW- AND MODERATE-INCOME NEIGHBORHOOD.—The term 'low- and moderate-income neighborhood' means a neighborhood described in section 17(c)(2)(B) of the Housing Act of 1937.

"(3) LOW- AND MODERATE-INCOME PERSONS.—The term 'low- and moderate-income persons' has the meaning given to such term in section 102(a)(20) of the Housing and Community Development Act of 1974.".

SEC. 404. AMENDMENTS RELATING TO SAVINGS AND LOAN HOLDING COMPANIES.

Section 408 of the National Housing Act (12 U.S.C. 1730a) is amended by adding at the end thereof the following new subsection:

"(u) COMMUNITY BENEFITS REQUIREMENTS.—

"(1) MINIMUM COMMUNITY REINVESTMENT RATING REQUIRED FOR CERTAIN APPROVALS.—

"(A) In general.—Unless the requirements of subparagraph (B) are met, the Corporation shall not approve—

"(i) any application under subsection (e)(1)(A) by any savings and loan holding company to acquire control of another insured institution (other than an insured institution described in subclause (I) or (II) of paragraph (6)(B)(i)) or any savings and loan holding company;

"(ii) any application under subsection (e)(1)(B) by any insured institution (other than an insured institution described paragraph (6)(B)(i)) to acquire control of another insured institution (other than an insured institution described in subclause (I) or (II) of paragraph (6)(B)(i)) or any savings and loan holding company; or

"(iii) any application by a savings and loan holding company to engage in any activity (or to acquire the shares of any company engaged in any activity) described in subsection (c)(2)(F) for which the Corporation's approval is required.

"(B) MINIMUM COMMUNITY REINVESTMENT RATING REQUIREMENTS.—The requirements of this subparagraph are met if—

"(i) in the case of an application described in clause (i) or (iii) of subparagraph (A), the applicant savings and loan holding company has an imputed community reinvestment rating of 2 or better (as determined in accordance with paragraph (6)); or

"(ii) in the case of an application described in clause (ii) of subparagraph (A), the applicant insured institution has a community reinvestment rating of 2 or better (as determined under section 810 of the Community Reinvestment Act of 1977).

"(C) SPECIAL RULES FOR THRIFTS, ETC., WITH ABOVE AVERAGE COMMUNITY REINVESTMENT RATINGS.—

"(i) WRITTEN FINDINGS WITHIN 60 DAYS IF NO HEARING IS HELD.—In the case of an application described in clause (i) or (iii) of subparagraph (A) by a savings and loan holding company described in subparagraph (B)(i) or an application described in subparagraph (A)(ii) by an insured insti-

tution described in subparagraph (B)(ii), if—

"(I) no comments are received under paragraph (8)(A); or

"(II) with respect to comments received, the Corporation determines that no substantial issue referred to in paragraph (8)(B)(i) has been raised,

the Corporation shall issue a written finding which meets the requirement of paragraph (8)(C) before the end of the 60-day period beginning on the later of the dates described in clauses (i) and (ii) of paragraph (8)(A).

"(ii) WRITTEN FINDINGS WITHIN 90 DAYS IF A HEARING IS HELD.—If a hearing is conducted under paragraph (8)(B) in connection with an application described in clause (i) or (iii) of subparagraph (A) by a savings and loan holding company described in subparagraph (B)(i) or an application described in subparagraph (A)(ii) by an insured institution described in subparagraph (B)(ii), the Corporation shall issue a written finding which meets the requirement of paragraph (8)(C) before the end of the 90-day

period beginning on the later of the dates described in clauses (i) and (ii) of paragraph (8)(A).

"(2) PRELIMINARY APPROVAL WITH REVIEW PERIOD IN CERTAIN OTHER CASES.—

"(A) PRELIMINARY APPROVAL.—Notwithstanding paragraph (1), the Corporation may preliminarily approve an application described in such subsection if—

"(i) in the case of an application by—

"(I) a savings and loan holding company, such savings and loan holding company has an imputed community reinvestment rating of 3 (as determined in accordance with paragraph (6)); or

"(II) an insured institution, the applicant insured institution has a community reinvestment rating of 3; and

"(ii) the savings and loan holding company or insured institution enters into such commitments as the Corporation may require, taking into account any public comments or testimony received under paragraph (8), to take actions that will enable the com-

pany, including the resulting savings and loan holding company in the case of an application by an insured institution, to receive the imputed community reinvestment rating described in paragraph (1)(B)(i) before the end of the 2-year period beginning on the date of the preliminary approval of such application.

"(B) REVIEW.—At the end of the 180-day period beginning on the date the Corporation preliminarily approved an application described in paragraph (1) pursuant to subparagraph (A) of this paragraph, the Corporation shall review the policies and programs adopted by the applicant to implement the commitments described in subparagraph (A)(ii) of this paragraph.

"(C) EXPIRATION OF PRELIMINARY APPROVAL; FINAL APPROVAL.—No preliminary approval by the Corporation under subparagraph (A) of this paragraph of an application described in paragraph (1) of this subsection shall be effective after the end of the 30-day period beginning at the end of the 180-day period described in subparagraph (B) unless the Corporation approves

such application in a final written approval issued before the end of such 30-day period.

"(D) CONDITION ON FINAL APPROVAL.—The Corporation may not approve an application in a final written approval under subparagraph (C) of this paragraph unless the Corporation determines, pursuant to the review under subparagraph (B), that the policies and programs adopted by the applicant to implement the commitments described in subparagraph (A)(ii) of this paragraph have a substantial likelihood of resulting in the fulfillment of such commitments.

"(E) PUBLIC HEARING.—At the end of the 2-year period described in subparagraph (A) of this paragraph, the Corporation shall hold a public hearing with respect to any savings and loan holding company which receives final approval under subparagraph (C) at which interested community and consumer groups shall be given opportunity to testify concerning the savings and loan holding company's performance in fulfilling the commitments described in subparagraph (A)(ii).

"(F) APPROVAL ALLOWED FOR CERTAIN ACQUISITIONS INVOLVING INSURED INSTITU-

TION WITH RATING OF LESS THAN 3.—Notwithstanding paragraph (1) and subject to all the requirements of subparagraphs (B) through (E), the Corporation may preliminarily approve, under subparagraph (A), an application under subsection (e)(1) (to which subsection (e)(3) does not apply) by—

"(i) an insured institution with a community reinvestment rating of less than 3 for the acquisition of control of another insured institution; or

"(ii) any savings and loan holding company for the acquisition of control of any insured institution with a community reinvestment rating of less than 3,

if the acquiring insured institution or savings and loan holding company enters into commitments described in subparagraph (A)(ii) of this paragraph.

"(G) PRELIMINARY APPROVAL TREATED AS FINAL APPROVAL FOR CERTAIN PURPOSES.—A preliminary approval by the Corporation under subparagraph (A) of this paragraph of any application shall be treated as a final order

with respect to such application for purposes of subsection (k) of this section.

"(3) CORPORATION DISAPPROVAL REQUIRED IF APPLICANT EXHIBITS CERTAIN PATTERNS OF ACTIVITY.—

"(A) IN GENERAL.—The Corporation shall not approve an application described in paragraph (1)(A) if the applicant savings and loan holding company or any insured institution subsidiary of such company or the applicant insured institution has established a pattern of—

"(i) acquiring or chartering federally insured depository institutions in a manner that tends to exclude low- and moderate-income neighborhoods or equivalent areas; or

"(ii) opening or closing deposit facilities within the service area of any insured institution subsidiary, in the case of an applying savings and loan holding company, or of the applying insured institution in a manner that tends to exclude low- and moderate-income neighborhoods or equivalent areas, except that the closing of any deposit facility which the Corporation determines was occasioned by considerations relating to the

safety and soundness of a depository institution shall not be taken into account for purposes of this subparagraph.

"(B) RECONSIDERATION.—The Corporation may reconsider any application described in subparagraph (A) during the 90-day period following disapproval of such application if the applying savings and loan holding company, or the applying insured institution, submits a plan that the Corporation determines would reasonably be expected to improve services for low- and moderate-income persons and neighborhoods.

"(4) ADDITIONAL REQUIREMENT RELATING TO SECURITIES ACTIVITIES.—The Corporation shall not approve—

"(A) any application by a savings and loan holding company to engage in any securities activity (or acquire the shares of any company engaged in any securities activity); or

"(B) any application under subsection (e)(1)(B) to acquire an insured institution by any company which is not an insured institution or savings and loan holding company,

unless the applicant company enters into such commitments as the Corporation may require, taking into ac-

count any public comments or testimony received under paragraph (8), to provide reasonable assurance that the proposed combination of insured institution activities and securities activities (if any) within the savings and loan holding company structure following the approval of such application will not diminish the availability of credit and deposit services for low- and moderate-income persons or within low- and moderate-income neighborhoods or equivalent areas.

"(5) ADDITIONAL REQUIREMENTS RELATING TO COMPANIES WHICH ARE NOT THRIFTS OR HOLDING COMPANIES.—The Corporation may not approve an application under subsection (e)(1)(B) by any company which is not an insured institution or a savings and loan holding company at the time of application to—

"(A) acquire an insured institution with a community reinvestment rating less favorable than 2 unless the firm enters into such commitments as the Corporation may require, taking into account any public comments or testimony received under paragraph (8), to take actions that will enable the insured institution to achieve a community reinvestment rating of 2 or better before the end of the

2-year period beginning on the date of the approval of such application; or

"(B) acquire an insured institution with a community reinvestment rating of 1 or 2 unless the firm enters into such commitments as the Corporation may require, taking into account any public comments or testimony received under paragraph (8), to take actions that will enable the insured institution to maintain or improve such insured institution's community reinvestment rating.

"(6) IMPUTED COMMUNITY REINVESTMENT RATING.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the imputed community reinvestment rating for any savings and loan holding company (for purposes of this subsection) is the community reinvestment rating assigned to the insured institution subsidiary of such company with the least favorable community reinvestment rating.

"(B) EXCLUSION OF CERTAIN DEPOSITORY INSTITUTIONS.—

"(i) IN GENERAL.—Subject to clause (ii), the community reinvestment ratings of

the following depository institutions shall not be taken into account for purpose of determining the imputed community reinvestment rating for any savings and loan holding company under subparagraph (A):

"(I) Any insured institution which was acquired by such savings and loan holding company in an acquisition under section 408(m) of the National Housing Act, during the 2-year period beginning on the date such acquisition is made.

"(II) Any insured institution with a CAMEL composite rating of 4 or less under the Uniform Financial Institutions Rating System (or an equivalent rating under a comparable system), or a similarly weakened insured institution, which is acquired by such savings and loan holding company, during the 2-year period beginning on the date such acquisition is made.

"(III) Any insured institution which commences operations de novo,

during the 2-year period beginning on the date such operations commence.

"(ii) PLAN.—Clause (i) of this subparagraph shall apply with respect to any savings and loan holding company only if, within the 90-day period beginning on the date an insured institution described in such clause is acquired or commences operations, such savings and loan holding company submits a plan that the Corporation determines would reasonably be expected to enable such insured institution to receive a community reinvestment rating of 1 or 2 (as determined under section 810 of the Community Reinvestment Act of 1977).

"(iii) TRANSITION RULE FOR CERTAIN ACQUISITIONS.—In the case of any insured institution described in subclause (I) or (II) of clause (i) which was acquired by any savings and loan holding company after December 31, 1985, and before the date of the enactment of the Depository Institutions Act of 1988, the community reinvestment ratings of such insured institution shall not be taken into account for purposes of determining the

imputed community reinvestment rating for such savings and loan holding company under subparagraph (A) during the 2-year period beginning on the date of the enactment of such Act if such savings and loan holding company submits a plan described in clause (ii) before the end of the 90-day period beginning on the date of the enactment of such Act.

"(C) EXCLUSION OF CERTAIN AGRICULTURAL THRIFTS AND THRIFTS WITH ASSETS OF NOT MORE THAN $25,000,000.—

"(i) IN GENERAL.—The community reinvestment ratings of the following insured institutions shall not be taken into account for purposes of determining the imputed community reinvestment rating for any savings and loan holding company under subparagraph (A):

"(I) Any agricultural insured institution with assets of $50,000,000 or less.

"(II) Any insured institution with assets of $25,000,000 or less.

"(ii) AGRICULTURAL INSURED INSTITUTION DEFINED.—For purposes of clause (i), the term 'agricultural insured institution' means any insured institution which has 25 percent or more of its loan assets in agricultural loans or real estate loans made by such institution to customers located in the market area served by such institution.

"(iii) AGRICULTURAL LOAN DEFINED.—For purposes of clause (i), the term 'agricultural loan' means—

"(I) any loan made to finance the production of agricultural products or livestock in the United States;

"(II) any loan secured by farmland or farm machinery in the United States; and

"(III) any other category of loans which the Corporation determines have been made for agricultural purposes.

"(7) NOTICE REQUIRED.—

"(A) NOTICE.—Any savings and loan holding company, insured institution, or other company which submits an application described in paragraph (1)(A) or (5) to the Corporation shall

provide notice of such action to the public in such manner as the Corporation shall prescribe by regulation.

"(B) Bulletins required.—The Corporation shall—

"(i) prepare a weekly bulletin listing the savings and loan holding companies, insured institutions, and other companies which have submitted applications described in paragraph (1)(A) or (5) since the last bulletin was prepared; and

"(ii) shall mail such bulletin without charge to any person upon request.

"(8) COMMENTS REQUIRED TO BE ACCEPTED AND CONSIDERED; WRITTEN FINDINGS.—

"(A) OPPORTUNITY FOR COMMENT.—Before approving any application described in paragraph (1)(A) or (5), the Corporation shall accept public comments on the application during a period of not less than 45 days beginning on the later of—

"(i) the date of the notice required pursuant to paragraph (7)(A); or

"(ii) the date on which the Corporation published the weekly bulletin required under

paragraph (7)(B) which contains the notice of such application.

"(B) HEARING.—The Corporation may hold an informal hearing relating to any application described in paragraph (1)(A) or (5) at the request of any person who submitted comments under subparagraph (A) of this paragraph with respect to such application which, in the judgment of the Corporation, raises a substantial issue with respect to—

"(i) the performance of—

"(I) the applicant savings and holding company or any insured institution subsidiary of such holding company or the applicant insured institution; or

"(II) in the case of an application by another company, the insured institution which such firm proposes to acquire,

in serving local community credit needs; or

"(ii) the adequacy of any commitment made by the applicant pursuant to paragraph (2)(A)(ii), (4), or (5).

"(C) WRITTEN FINDINGS.—Before approving any application described in paragraph (1)(A) or (5), the Corporation shall prepare a written finding with respect to each factor the Corporation is required to take into account in considering such application, or in making any determination with respect to such application, under this subsection.

"(9) PUBLIC AVAILABILITY OF COMMITMENTS.—Any commitment proposed or agreed to under paragraph (2)(A)(ii), (4), or (5) by any savings and loan holding company or other company in connection with an application described in paragraph (1)(A) shall be available to the public.

"(10) CONTINUING ENFORCEMENT.—If—

"(A) at any time after a saving and loan holding company receives final approval of an application under paragraph (1), (2)(C), or (5) (including any insured institution or other company which becomes a savings and loan holding company by reason of such approval)—

"(i) such savings and loan holding company receives an imputed community reinvestment rating of 4 or 5; or

"(ii) such savings and loan holding company violates the terms of any commitment made by such company under paragraph (2)(A)(ii), (4), or (5); and

"(B) before the end of the 18-month period beginning on the date such company received the community reinvestment rating described in subparagraph (A)(i) or committed the violation described in subparagraph (A)(ii), such company has not—

"(i) received an imputed community reinvestment rating of 3 or better; or

"(ii) come into compliance with the terms of such company's commitments,

the failure of the savings and loan holding company to maintain an imputed community reinvestment rating of 3 or better or to remain in compliance with the terms of such company's commitments shall be treated as a violation of this section by such company for purposes of subsection (j)(4) of this section.

"(11) DEFINITIONS.—For purposes of this subsection—

"(A) COMMUNITY REINVESTMENT RATING.—The term 'community reinvestment rating' means, with regard to an insured institu-

tion, the numerical rating assigned to such insured institution pursuant to section 810 of the Community Reinvestment Act of 1977 or subsection (e)(3) of this section.

"(B) LOW- AND MODERATE-INCOME NEIGHBORHOOD.—The term 'low- and moderate-income neighborhood' means a neighborhood described in section 17(c)(2)(B) of the Housing Act of 1937.

"(C) LOW- AND MODERATE-INCOME PERSONS.—The term 'low- and moderate-income persons' has the meaning given to such term in section 102(a)(20) of the Housing and Community Development Act of 1974.".

SEC. 405. AMENDMENTS TO THE COMMUNITY REINVESTMENT ACT OF 1977.

(a) IN GENERAL.—The Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) is amended by adding at the end thereof the following new sections:

"SEC. 807. NOTICE OF EXAMINATION.

"(a) NOTICE REQUIRED.—When an examination of an insured depository institution begins under section 804(1), the appropriate Federal depository institutions regulatory agency shall publish a notice of the examination (on the same day such examination begins) in a newspaper of

general circulation in the community in which such institution is located.

"(b) CONTENTS OF NOTICE.—Any notice required under subsection (a) shall inform the public of its right to submit to the Federal depository institutions regulatory agency any comments in writing or by interview with regard to the insured depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.

"(c) WEEKLY BULLETIN.—Each regional unit of each Federal depository institutions regulatory agency shall—

"(1) prepare a weekly bulletin that lists all insured depository institutions within the region of such unit for which public notice under this section has been given since the publication of the preceding bulletin; and

"(2) promptly mail a copy of such bulletin without charge to any person upon request.

"SEC. 808. PERFORMANCE DATA COLLECTION.

"(a) ESTABLISHMENT REQUIRED.—The appropriate Federal depository institutions regulatory agencies shall jointly develop a format for collecting data from insured depository institutions, in connection with examinations under section 804, concerning such institutions' record of meeting

the credit needs of their local communities, including low- and moderate-income neighborhoods.

"(b) VARIATION IN FORMAT.—The format for collecting performance data established under subsection (a) may vary for different size categories of institutions and may vary between bank and thrift institutions.

"(c) REQUIRED DATA FOR LARGE DEPOSITORY INSTITUTIONS.—In the case of insured depository institutions with assets of $100,000,000 or more, the format established pursuant to subsection (a) shall collect performance data for, at a minimum, the following assessment factors:

"(1) Housing loans in low- and moderate-income neighborhoods or equivalent areas.

"(2) Small business and small farm loans.

"(3) Financial investments in and contributions to local community development or redevelopment projects or entities, with separate subcategories for low- and moderate-income housing and small business projects or entities and further itemization by nonprofit and for-profit status.

"(4) Participation in governmentally or privately sponsored loan insurance, guarantee, or subsidy programs for housing, small businesses, or small farms.

"(5) The scope of efforts to market housing and small business loans in low- and moderate-income neighborhoods and minority neighborhoods.

"(d) SIMPLIFIED DATA COLLECTION FOR CERTAIN DEPOSITORY INSTITUTIONS.—

"(1) IN GENERAL.—In developing the format for collecting data under subsection (a) as such format relates to depository institutions with total assets of $25,000,000 or less and agricultural depository institutions with total assets of $50,000,000 or less, the special nature and the limited resources of such depository institutions shall be taken into account.

"(2) AGRICULTURAL DEPOSITORY INSTITUTIONS DEFINED.—For purposes of paragraph (1), the term 'agricultural depository institution' means any depository institution which has 25 percent or more of its loan assets in agricultural loans or real estate loans made by such institution to customers located in the market area served by such institution.

"(3) AGRICULTURAL LOAN DEFINED.—For purposes of paragraph (2), the term 'agricultural loan' means—

"(A) any loan made to finance the production of agricultural products or livestock in the United States;

"(B) any loan secured by farmland or farm machinery in the United States; and

"(C) any other category of loans which the appropriate Federal depository institutions regulatory agency determines have been made for agricultural purposes.

"SEC. 809. WRITTEN EVALUATIONS.

"(a) REQUIRED.—

"(1) IN GENERAL.—Upon the conclusion of each examination of an insured depository institution under section 804, the appropriate Federal depository institutions regulatory agency shall prepare a written evaluation of the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.

"(2) PUBLIC AND CONFIDENTIAL SECTIONS.—Each written evaluation required under paragraph (1) shall have an public section and a confidential section.

"(b) PUBLIC SECTION OF REPORT.—

"(1) FINDINGS AND CONCLUSIONS.—The public section of the written evaluation shall—

"(A) state the appropriate Federal depository institutions regulatory agency's conclusions for each assessment factor identified in the regulations prescribed by the Federal depository institu-

tions regulatory agencies to implement this Act; and

"(B) discuss the facts supporting such conclusions, including the information contained in the data collection format established pursuant to section 808.

"(2) EMPHASIS ON SPECIFIC TYPES OF CREDIT.—The statement, discussion, supporting facts, and conclusions shall place special emphasis on the insured depository institution's record of serving the housing credit needs of low- and moderate-income persons, small business credit needs, and small farm credit needs.

"(3) ASSIGNED NUMERICAL RATING.—The public section shall also contain the institution's numerical rating required by section 810 and a statement describing the basis for the rating.

"(4) SUBMISSION TO DEPOSITORY INSTITUTION.—The open section and the corresponding data performance format required by section 808 shall be submitted to the institution and made available to the public.

"(c) CONFIDENTIAL SECTION OF REPORT.—

"(1) PRIVACY OF NAMED INDIVIDUALS.—The confidential section of the written evaluation shall con-

tain all references that identify any customer of the institution, any employee or officer of the institution, any person or organization that has provided information in confidence to a Federal or State depository institutions regulatory agency.

"(2) OTHER TOPICS NOT SUITABLE FOR DISCLOSURE.—The confidential section shall also contain any inflammatory statements or other such statements which, in the judgment of the appropriate Federal depository institutions regulatory agency, are not properly subject to disclosure to the institution or the public.

"(3) NONDISCLOSURE TO DEPOSITORY INSTITUTION.—The confidential section shall not be disclosed to the institution or the public, unless the appropriate Federal depository institutions regulatory agency determines that such disclosure would be in the public interest.

"SEC. 810. PERFORMANCE RATING SYSTEM.

"(a) GUIDELINES REQUIRED TO BE DEVELOPED.—

"(1) IN GENERAL.—The Federal depository institutions regulatory agencies shall jointly develop and publish rating guidelines for assigning a numerical rating to an insured depository institution's performance in meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.

"(2) Rating methodology.—The underlying goal of the rating process shall be to measure the extent to which an insured depository institution is committing financial and managerial resources to community reinvestment activities. The rating guidelines shall expect—

"(A) comparable resource commitments from institutions within the same size category; and

"(B) institutions located in distressed areas where credit needs are more extreme to be held to equivalent levels of resource commitments as institutions in communities with stronger economies.

"(3) Public notice and opportunity to comment.—Before developing and publishing the guidelines under paragraph (1), the appropriate Federal depository institutions regulatory agencies shall—

"(A) provide public notice in a manner appropriate to achieve broad public knowledge of—

"(i) the requirements of paragraphs (1) and (2);

"(ii) the period for submitting comments under subparagraph (B); and

"(iii) the time and location of the public hearings required under subparagraph (C);

"(B) solicit public comment on the issues which are relevant to the development of rating guidelines; and

"(C) conduct a separate public hearing at the head office of each Federal Reserve bank on the issues which are relevant to the development of rating guidelines.

"(4) ANNUAL REVIEW.—The Federal depository institutions regulatory agencies shall annually review, and revise when appropriate, the rating guidelines established under paragraph (1).

"(5) VIEWS OF COMMUNITY REVIEW BOARDS AND CONSUMER AND COMMUNITY GROUPS.—Any review under paragraph (4) shall take into account the views of—

"(A) the community review boards established pursuant to section 412 of the Depository Institutions Act of 1988 by the Federal Reserve banks; and

"(B) interested community and consumer groups.

"(b) NUMERICAL RATING.—

"(1) ASSIGNMENT REQUIRED.—Based on the guidelines established under subsection (a), the appropriate Federal depository institutions regulatory

agency shall assign a numerical rating to an institution's record of performance in meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.

"(2) TIME OF ASSIGNMENT.—The numerical rating required under paragraph (1) shall be assigned upon the completion of an assessment of the institution pursuant to section 804 of this title.

"(3) SUBSEQUENT MODIFICATION FOR APPLICATION PURPOSES.—In considering an application for a deposit facility, an application described in subsection (a)(1) or (e) of section 11 of the Bank Holding Company Act of 1956, or an application described in paragraph (1)(A) or (5) of section 408(u) of the National Housing Act, the appropriate Federal depository institutions regulatory agency, the Board of Governors of the Federal Reserve System (in the case of a bank holding company), or the Federal Savings and Loan Insurance Corporation (in the case of a savings and loan holding company), as the case may be—

"(A) shall review the numerical rating assigned under section 804 to any insured depository institution involved with respect to such application; and

"(B) may, based on the record developed in the application proceeding, modify such rating for the purpose of acting on such application.

"(c) PERFORMANCE SCALE.—

"(1) RELATIVE RANKINGS REQUIRED.—Any community reinvestment rating assigned under this subsection with respect to any insured depository institution shall reflect such institution's community reinvestment performance on a comparative basis relative to the community reinvestment performances of other insured depository institutions with similar resources.

"(2) 5-GRADE PERFORMANCE SCALE.—The numerical rating assigned with respect to any insured depository institution shall be determined on the basis of the following 5-grade performance rating scale:

"(A) 1—excellent.

"(B) 2—good.

"(C) 3—average.

"(D) 4—limited effort.

"(E) 5—poor or substantial noncompliance.

"SEC. 811. ACTIVITIES OF NONBANK SUBSIDIARIES.

"In assessing, compiling data on, or rating the performance of an insured depository institution under this Act or for purposes of the consideration of an application for a deposit facility, an application or notice described in section

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11(a)(1) of the Bank Holding Company Act, or an application described in section 408(u)(1)(A) of the National Housing Act, a Federal depository institutions regulatory agency may take into consideration—

"(1) the activities of the insured depository institution's parent holding company or nonbank or nonthrift institution affiliates which help to meet the credit needs of the insured depository institution's local community, including low- and moderate-income neighborhoods; and

"(2) the activities of any community development corporation—

"(A) which is sponsored by such insured depository institution or the holding company which controls such insured depository institution; and

"(B) the activities of which are targeted to meet the credit needs of low- and moderate-income persons or small businesses or low- and moderate-income neighborhoods or equivalent areas.

"SEC. 812. ANNUAL REPORT TO CONGRESS.

"Before March 1 of each calendar year, the appropriate Federal depository institutions regulatory agencies shall submit a report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the

Senate containing a compilation of the data collected during the preceding calendar year under sections 807 through 811 of this Act.".

(b) TRANSITION RULE.—In the case of any application or notice described in subsection (a)(1) of section 11 of the Bank Holding Company of 1956 (as added by section 403 of this title), other than an application to establish a qualified securities subsidiary, and any application described in section 408(u)(1)(A) of the National Housing Act (as added by section 404 of this title), the most recent community reinvestment rating assigned under the most recent community reinvestment examination of any depository institution conducted before the date of the enactment of this Act shall be taken into account for purposes of such section until the earlier of—

(1) the end of the 2-year period beginning on such date of enactment; or

(2) the date the next community reinvestment examination is conducted after such date of enactment.

(c) EXTENSION OF 2-YEAR PERIOD ALLOWED.—If no community reinvestment examination of any depository institution is conducted before the end of the 2-year period described in subsection (b)(1), such period may be extended by the appropriate Federal depository institution regulatory agencies (for not to exceed 6 months at a time) for such bank

or insured institution until the next community reinvestment examination is conducted after such date of enactment.

(d) PERIODIC AGENCY REPORTS.—Before the end of the 6-month period beginning on the date of the enactment of this Act and each 6 months thereafter, each appropriate Federal depository institutions regulatory agency shall submit a report to the Congress containing the following information:

(1) The number of depository institutions for which community reinvestment examinations have been conducted since the date of the enactment of this Act.

(2) The number of depository institutions for which community reinvestment examinations have not been conducted since such date.

(3) The number of extensions which have been granted under subsection (c) since the date of the most recent report under this subsection.

(4) Detailed reasons for the number of depository institutions for which community reinvestment examinations have not been conducted since such date.

This subsection shall not apply after all depository institutions have been examined after the date of the enactment of this Act.

(e) TECHNICAL AND CONFORMING AMENDMENTS.—The Community Reinvestment Act of 1977 (12 U.S.C. 2901

et seq.) (as in effect before the amendment made by subsection (a)) is amended—

(1) by striking out "financial supervisory agency" each place such term appears in such Act and inserting in lieu thereof "depository institutions regulatory agency";

(2) by striking out "regulated financial institution" each place such term appears in such Act and inserting in lieu thereof "insured depository institution"; and

(3) by striking out "regulated financial institutions" each place such term appears in such Act and inserting in lieu thereof "insured depository institutions".

Subtitle B—Agency Reforms

SEC. 411. CONSUMER DIVISIONS.

(a) ESTABLISHMENT REQUIRED.—The Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board shall each establish within their respective agencies a separate division to be known as the "consumer division".

(b) DEFINITIONS.—For purposes of this section—

(1) CONSUMER EXAMINATION.—The term "consumer examination" means an examination of an in-

sured depository institution to determine the extent to which such institution is in compliance with all applicable laws and regulations relating to consumer protection, including community reinvestment laws.

(2) CONSUMER EXAMINER.—The term "consumer examiner" means an examiner who specializes in assessing compliance with all applicable laws and regulations relating to consumer protection, including community reinvestment laws.

(3) INSURED DEPOSITORY INSTITUTION.—The term "insured depository institution" means any insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act) and any insured institution (as defined in section 401(a) of the National Housing Act).

(c) CONSUMER EXAMINATIONS.—

(1) FREQUENCY.—Each consumer division established pursuant to subsection (a) shall no less frequently than once every 2 years conduct a separate onsite examination of each insured depository institution within the jurisdiction of the agency of which such division is a part to determine the extent to which such institution is in compliance with all applicable laws and regulations relating to consumer protection, including community reinvestment laws.

(2) CONDUCTED BY CONSUMER EXAMINERS.—In general, consumer examinations shall be conducted by consumer examiners under the supervision of a consumer division.

(3) EXAMINATION UPON REQUEST UNDER CERTAIN CIRCUMSTANCES.—If any bank holding company or savings and loan holding company which controls an insured depository institution determines that a consumer examination of such depository institution in advance of the next scheduled examination under paragraph (1) may be appropriate to expedite an application or notice by the holding company under the Bank Holding Company Act of 1956 or section 408 of the National Housing Act, the holding company may request in writing the appropriate consumer division to conduct a consumer examination of the depository institution.

(d) ADDITIONAL RESPONSIBILITIES.—In addition to the responsibilities established by subsection (c), each consumer division shall—

(1) develop procedures for consumer examinations;

(2) train, supervise, and develop career paths for consumer examiners;

(3) respond to consumer complaints;

(4) undertake supervisory action and initiate enforcement proceedings with respect to all applicable laws and regulations relating to consumer protection, including community reinvestment laws;

(5) develop proposed regulations to implement all applicable laws relating to consumer protection, including community reinvestment laws;

(6) make recommendations to its agency concerning policies and procedures with respect to all applicable laws and regulations relating to consumer protection, including community reinvestment laws; and

(7) prepare an annual report regarding the activities of the consumer division.

(e) EFFECTIVE DATES.—

(1) CONSUMER DIVISION.—The establishment of separate consumer divisions in each of the agencies listed in subsection (a) shall be completed no later than January 1, 1991.

(2) INTERIM REPORT REQUIRED.—Each agency listed in subsection (a) shall submit a report on the steps taken to implement the establishment of the consumer division in such agency to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Hous-

ing, and Urban Affairs of the Senate before June 30, 1988.

SEC. 412. COMMUNITY REVIEW BOARDS.

(a) ESTABLISHMENT REQUIRED.—Each Federal Reserve bank shall establish a community review board.

(b) MEMBERSHIP.—

(1) IN GENERAL.—Each community review board established under subsection (a) shall consist of 16 members selected as follows:

(A) 4 members appointed in the manner provided in paragraph (2) from among individuals who are representatives of consumer organizations.

(B) 4 members appointed in the manner provided in paragraph (2) from among individuals who are representatives of community organizations.

(C) 4 members appointed in the manner provided in paragraph (2) from among individuals who are representatives of civil rights organizations.

(D) 4 members appointed in the manner provided in paragraph (2) from among individuals who are representatives of regulated financial institutions.

(2) APPOINTMENT.—Of the members described in each subparagraph of paragraph (1) with respect to each community review board established under subsection (a), 1 member shall be appointed by each Federal depository institutions regulatory agency (as defined in section 803(1) of the Community Reinvestment Act of 1977).

(3) TERMS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), members of community review boards shall be appointed for terms of 2 years.

(B) STAGGERED TERMS.—Of the members first appointed to each community review board—

(i) 2 of the members described in each subparagraph of paragraph (1) shall be appointed for a term of 3 years; and

(ii) 2 of the members described in each subparagraph of paragraph (1) shall be appointed for a term of 2 years,

as designated by the Federal depository institutions regulatory agency making the appointment under paragraph (2) at the time of such appointment in accordance with procedures jointly prescribed by such agencies.

(4) VACANCY.—Any vacancy on the board shall be filled in the manner in which the original appointment was made.

(c) CHAIRPERSON.—The chairperson of each community review board shall be elected by majority vote of the members of such board.

(d) COMPENSATION; EXPENSES.—Members of each board shall serve without compensation but each member shall be reimbursed by the Federal depository institutions regulatory agency that appointed such member for expenses incurred in connection with attendance of such member at meetings of the board.

(e) MEETINGS.—Each community review board shall meet on a quarterly basis at the offices of the Federal Reserve bank which established such board.

(f) DUTIES.—The duties of each community review board are as follows—

(1) advise the Federal depository institutions regulatory agencies with respect to the concerns of financial service consumers and credit needs of local communities within the board's region;

(2) review the performance of the Federal depository institutions regulatory agencies within the board's region in regard to examination standards and practices, disposition of consumer complaints, and proce-

dures for enforcement of all applicable laws and regulations relating to consumer protection, including community reinvestment laws;

(3) make recommendations to the Federal depository institutions regulatory agencies regarding improvements in examination standards and practices, disposition of consumer complaints, and procedures for enforcement of all applicable laws and regulations relating to consumer protection, including community reinvestment laws;

(4) prepare an annual report on the board's activities, which shall include—

(A) its findings in regard to the concerns of financial service consumers and local community credit needs;

(B) summarize its review of the agencies' performance; and

(C) summarize its recommendations to the agencies.

(g) ADMINISTRATIVE SUPPORT.—Each Federal Reserve bank shall—

(1) provide administrative support to enable the community review board for such bank's district to perform the board's duties; and

(2) publish the community review board's annual report.

(h) Effective Date.—Each community review board shall be established and the first members appointed no later than June 30, 1989.

Subtitle C—Access to Financial Services

SEC. 421. SHORT TITLE.

This subtitle may be cited as the "Financial Services Access Act".

SEC. 422. BASIC FINANCIAL SERVICES ACCOUNT.

(a) 2-Tier Basic Financial Service Accounts Required.—Each depository institution shall offer a basic financial services account which—

(1) may be used to obtain, at the election of the customer—

(A) basic transaction services; and

(B) government check cashing services; and

(2) meets the requirements of this section.

(b) Account Registration.—

(1) In general.—The Board of Governors of the Federal Reserve System shall prescribe such regulations as may be necessary to establish the customer registration program required to open a basic financial services account under subsection (a).

(2) MINIMUM REQUIREMENTS.—Regulations prescribed by the Board under paragraph (1) of this subsection shall contain, at a minimum, the following requirements:

(A) Each depository institution shall provide for registration in all of its offices staffed by individuals employed by such depository institution.

(B) Registration shall be by means of an application containing the application date, and the name, address, date of birth, and handwritten signature of the applicant as well as other information the Board reasonably determines to be necessary to facilitate registration of customers and obtaining basic transaction services and government check cashing services pursuant to this section.

(C) At the time of account registration, an applicant may be required to present an identification card in such form as the Board may require, which includes the signature and a photograph of such customer.

(D) The applicant shall be provided a copy of the completed account registration evidencing the fact that the registration has been received and filed with the depository institution within 15 days of such filing.

(3) REJECTION FOR INTENTIONAL MATERIAL MISREPRESENTATION.—If the depository institution determines that an intentional material misrepresentation has been made in the information provided to open a basic financial services account, the depository institution may reject such registration.

(4) INITIAL WAITING PERIOD FOR CASHING GOVERNMENT CHECKS.—The depository institution may impose a waiting period of not to exceed 20 days after the registration is completed before cashing any government check in connection with such account.

(c) REQUIREMENTS FOR ALL BASIC FINANCIAL SERVICES ACCOUNTS.—No account offered by a depository institution meets the requirement of this section with respect to basic financial service accounts if such account—

(1) requires other account relationships with such depository institution; or

(2) requires the individual to meet any prerequisite which discriminates against low-income individuals in order to open such account.

(d) ACCOUNTS PROVIDING BASIC TRANSACTION SERVICES.—A basic financial services account offered by a depository institution meets the requirements of this section with respect to providing basic transaction services if it is an account—

(1) which is available for such purpose only to individuals (or to members, in the case of a credit union) who have $1,000 or less on deposit at such depository institution;

(2) for which service charges or fees, if any, for routine transactions do not exceed a minimal amount (in accordance with regulations which the Board of Governors of the Federal Reserve System shall prescribe);

(3) which does not have a minimum opening or minimum balance requirement of more than $25;

(4) which, in the case of any depository institution which offers transaction accounts (as defined in section 19(b)(1)(C) of the Federal Reserve Act) in the ordinary course of business, permits checks, share drafts, negotiable orders of withdrawal, or similar instruments to be drawn on the account for purposes of making payments or other transfers to third parties;

(5) which permits not less than 10 withdrawals per month (including withdrawals described in paragraph (4)), whether by check, share draft, negotiable order of withdrawal, or other means;

(6) for which the depository institution is required to provide—

(A) a detailed monthly statement listing all transactions for the month involved; or

(B) a passbook in which the depository institution enters all transactions for such account;

(7) which does not require the individual to exclusively use automated teller machines or other nonteller services for such purpose;

(8) with respect to which, at the election of the individual, the depository institution may allow regularly recurring payments to the individual to be made by the payor to the depository institution for direct deposit into the account of such individual; and

(9) which may be closed after notice to the individual by reason of the occurrence of—

(A) overdrafts with respect to the account of such individual on 3 separate and distinct occasions within any 6-month period; or

(B) a pattern of fraudulent activity involving the account of such individual.

(e) ACCOUNTS PROVIDING GOVERNMENT CHECK CASHING SERVICES.—A basic financial services account offered by a depository institution meets the requirements of this section with respect to providing government check cashing services if it is an account—

(1) which is available to individuals (or to members, in the case of a credit union) for the purpose of cashing government checks in amounts of $1,500 or less if the individual presenting the check is the individual to whom the check has been issued;

(2) which does not have a minimum opening or minimum balance requirement;

(3) which does not require other account relationships with such depository institution;

(4) which does not require the individual to meet any prerequisite which discriminates against low-income individuals in order to open such account;

(5) for which checking cashing fees, if any, for cashing government checks do not exceed $2 per check;

(6) which allows the customer to designate not less than 3 offices of such depository institution at which such customer may cash government checks upon presentation of—

(A) a copy of the registration provided in accordance with subsection (b)(2)(D) of this section;

(B) an identification card in the form described in subsection (b)(2)(C) of this section; and

(C) the basic financial services account number.

(f) INFORMATION ON ACCOUNTS.—Upon request of any individual, a depository institution shall provide such individual with a written summary describing the account offered by such depository institution which meets the requirements of subsection (a).

(g) GOVERNMENT CHECK DEFINED.—For purposes of this section, the term "government check" means any check which was issued by—

(1) the United States, any State, or any agency of the United States; or

(2) any agency of the State in which the check is presented for cashing purposes (in connection with a basic financial services account), any unit of local government of such State, or any agency of any such unit of local government.

(h) SPECIAL RULE FOR CREDIT UNIONS.—Any credit union which, in the ordinary course of business, cashes checks for members shall cash any government check in an amount of $1,500 or less for any member without charge if the member presenting the check is the individual to whom the check has been issued.

(i) SPECIAL RULE FOR CERTAIN DEPOSITORY INSTITUTIONS.—In the case of a depository institution which does not cash checks for customers, such depository institution shall not be required to provide government check cash-

ing services in connection with the basic financial services accounts offered by such depository institution.

(j) PREVENTION OF FRAUD LOSSES.—

(1) IN GENERAL.—With respect to the requirements of this section relating to government check cashing services, the Board may, by regulation or order, suspend any such requirement for any classification of checks if the Board determines that—

(A) depository institutions are experiencing an unacceptable level of losses due to check-related fraud with respect to such class of checks; or

(B) there is reasonable cause to believe that such class of checks is being used in a scheme to fraud.

(2) REPORT TO CONGRESS.—Within 10 days of issuing any order or prescribing any regulation under paragraph (1), the Board shall submit a report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate containing the reason for the order or regulation and the evidence considered in making the determination to issue an order or prescribe a regulation.

(k) EXCEPTION.—

(1) In general.—In accordance with regulations which the Board shall prescribe, this section shall not apply with respect to any government check presented for cashing to a depository institution if the depository institution has reasonable cause to believe that—

(A) such check is being fraudulently presented or has been altered or forged; or

(B) the identification card described in subsection (b)(2)(C) which is presented in connection with cashing such check has been altered or forged.

(2) Standard.—For purposes of paragraph (1), reasonable cause to believe requires the existence of facts which would cause a well-grounded belief in the mind of a reasonable person.

(l) Study and Report on Incidence of Fraud in Connection With Government Check Cashing.—

(1) Study required.—After the end of the 1-year period beginning on the effective date of regulations implementing the requirements of this section, the Board shall conduct a study of the check cashing services provided pursuant to this section during such year to determine whether, in any case, losses due to fraud in connection with providing such services are causing

the costs incurred by depository institutions in connection with providing such services to exceed revenues from the service fees collected or other income earned in connection with providing such services.

(2) REPORT REQUIRED.—Before the end of the 6-month period beginning at the end of the period referred to in paragraph (1), the Board shall submit a report to the Congress containing the findings and conclusions of the Board with respect to the study required under such paragraph, together with such recommendations for legislative and administrative action as the Board determines to be appropriate.

(m) STUDY AND REPORT ON DIRECT DEPOSIT PROGRAM FOR U.S. GOVERNMENT ENTITLEMENT PROGRAMS.—

(1) STUDY REQUIRED.—The Board shall conduct a study of the feasibility and desirability of requiring the direct deposit of of United States Government checks which are issued in connection with Federal entitlement programs to be paid directly to a depository institution designated by the payee for direct deposit into the payee's account and the implications of any such requirement.

(2) REPORT REQUIRED.—Before the end of the 90-day period beginning on the date of the enactment

of this Act, the Board shall submit a report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives containing the findings and conclusions of the Board with respect to the study required under paragraph (1), together with such recommendations for legislative and administrative action as the Board determines to be appropriate.

SEC. 423. POSTING OF NOTICES.

(a) NOTICE REQUIRED.—Each depository institution shall post a conspicuous notice in the appropriate area of each location where deposits are accepted that informs account holders and potential account holders that basic financial services accounts which provide basic transaction services and government check cashing services are available pursuant to this subtitle.

(b) CONTENTS OF NOTICE.—Any notice required under subsection (a) shall clearly explain the material features and limitations of basic financial services accounts, including basic transaction services and government check cashing services, so that customers can reasonably be expected to understand the terms of the account offered.

SEC. 424. ADMINISTRATIVE ENFORCEMENT.

(a) ADMINISTRATIVE ENFORCEMENT.—Compliance with the requirements imposed under this subtitle and regula-

tions prescribed by the Board under section 425 shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act—

(A) by the Comptroller of the Currency with respect to national banks;

(B) by the Board with respect to member banks of the Federal Reserve System (other than national banks); and

(C) by the Board of Directors of the Federal Deposit Insurance Corporation with respect to depository institutions insured by the Federal Deposit Insurance Corporation (other than national banks and member banks of the Federal Reserve System);

(2) section 5(d) of the Home Owners' Loan Act of 1933, section 407 of the National Housing Act, and sections 6(i) and 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation) with respect to any depository institution which is subject to any provision of such sections; and

(3) the Federal Credit Union Act, by the National Credit Union Administration Board with respect to any insured credit union.

(b) ADDITIONAL ENFORCEMENT POWERS.—

(1) VIOLATION OF THIS SUBTITLE TREATED AS VIOLATION OF OTHER ACTS.—For purposes of the exercise by any Federal depository institutions regulatory agency of any of such agency's powers under any Act referred to in subsection (a), a violation of—

(A) a requirement imposed under this subtitle shall be deemed to be a violation of a requirement imposed under that Act; and

(B) any regulation prescribed by the Board under section 425 shall be deemed to be a violation of a regulation prescribed by such agency under such Act.

(2) ENFORCEMENT AUTHORITY UNDER OTHER ACTS.—In addition to any Federal depository institutions regulatory agency's powers under any provision of law referred to in subsection (a), each such agency may exercise, for purposes of enforcing compliance with any requirement imposed under this subtitle, any other authority conferred on such agency by any other law.

SEC. 425. REGULATIONS.

The Board shall prescribe such regulations as such agency may determine to be appropriate to carry out the provisions of this subtitle.

SEC. 426. DEFINITIONS.

For purposes of this subtitle—

(1) APPROPRIATE FEDERAL DEPOSITORY INSTITUTIONS REGULATORY AGENCY.—The term "appropriate Federal depository institutions regulatory banking agency" means—

(A) the Comptroller of the Currency with respect to national banks;

(B) the Board with respect to member banks of the Federal Reserve System (other than national banks);

(C) the Board of Directors of the Federal Deposit Insurance Corporation with respect to federally insured depository institutions described in clause (i), (ii), or (iii) of section 19(b)(1)(A) of the Federal Reserve Act (other than national banks and member banks of the Federal Reserve System);

(D) the Federal Home Loan Bank Board with respect to federally insured depository institutions described in clause (v) or (vi) of section 19(b)(1)(A) of such Act; and

(E) the National Credit Union Administration Board with respect to federally insured depository institutions described in clause (iv) of section 19(b)(1)(A) of such Act.

(2) Board.—The term "Board" means the Board of Governors of the Federal Reserve System.

(3) Depository institution.—The term "depository institution" means any federally insured depository institution described in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act.

(4) State.—The term 'State' has the meaning given to such term in section 3(a) of the Federal Deposit Insurance Act.

SEC. 427. EFFECTIVE DATE.

This subtitle shall take effect at the end of the 90-day period beginning on the date of the enactment of this Act.

Subtitle D—Notice of Branch Closures By Bank and Thrift Institutions

SEC. 431. SHORT TITLE.

This subtitle may be cited as the "Notice of Bank and Thrift Branch Closure Act of 1988".

SEC. 432. NOTICE REQUIREMENTS FOR NATIONAL BANKS.

(a) Notice to Comptroller of the Currency Required.—In the case of any national banking association or District bank which proposes to close any branch of

such association or bank, such national banking association or District bank shall provide written notice of such proposed action to the Comptroller of the Currency not less than 90 days and not more than 180 days before such action is to occur.

(b) NOTICE TO CUSTOMERS.—

(1) NOTICE REQUIRED.—In the case of any national banking association or District bank which proposes to close any branch of such association or bank, such national banking association or District bank shall provide—

(A) notice of such proposed action to customers of such branch in the manner described in paragraph (2); and

(B) the mailing address of the Comptroller of the Currency and a statement that comments on the proposed closing of such branch may be mailed to the Comptroller of the Currency.

(2) METHOD.—Any notice required to be provided under paragraph (1) shall be provided in the following manner:

(A) POSTED ON BRANCH PREMISES.—A general notice of the plan to close a branch and the date such action is planned shall be posted in a conspicuous place on the premises of such

branch not later than the date on which written notice is provided to the Comptroller of the Currency pursuant to subsection (a).

(B) NOTICE IN STATEMENT OF ACCOUNT.—Notice of such plan shall be inserted in at least 1 of any periodic statements of account which are mailed—

(i) to any person who maintains an account at such branch; and

(ii) during the period beginning 180 days before the date such action is to occur and ending 90 days before such date.

(c) SUBSEQUENT INFORMATION REQUIREMENTS.—Unless no comments or only frivolous comments are received by the Comptroller of the Currency with respect to any plan to close a branch of a national bank or District bank before the end of the 30-day period beginning on the date written notice is provided by the bank of such proposed action to the Comptroller under subsection (a), the Comptroller of the Currency shall require such national bank or District bank to provide—

(1) a detailed statement of the reasons for the decision to close such branch;

(2) any statistical or other information in support of such reasons;

(3) a financial analysis of deposit activity at such branch during the 3-year period ending on the date of such notice (including the number of accounts, total dollar amounts of deposits, and profits and losses on such deposit activity), and a projection of the deposit activity that could be expected at such branch in the future if the branch were to remain open;

(4) a financial analysis of loan activity at such branch during the 3-year period ending on the date of such notice (including profits and losses on such loan activity), and a projection of the loan activity that could be expected at such branch in the future if the branch were to remain open;

(5) a detailed map of the area served by the branch showing the location of all other branches of depository institutions located within such area and the distance of each such branch from the branch proposed to be closed; and

(6) a description of, and the location of, any limited or full-service facility which such association or bank plans to establish in such area or which such association or bank has reason to believe another depository institution plans to establish in such area.

(d) Action Required of Comptroller of the Currency.—

(1) DETERMINATION ON AVAILABILITY OF SERVICES.—Whenever the Comptroller of the Currency receives any notice under subsection (a) with respect to any plan to close a branch, the Comptroller shall determine whether the closing of such branch will result in a significant reduction in the availability of the services of depository institutions in the area in which such branch is located.

(2) ASSISTANCE TO COMMUNITY.—If the Comptroller of the Currency determines that the closing of a branch will result in a significant reduction in the availability of services of depository institutions in the area in which such branch is located, the Comptroller shall consult with community leaders in the affected area, and with such other depository institutions as the Comptroller may determine to be appropriate, to explore the feasibility of replacing such branch with adequate banking facilities, including the establishment of a community development credit union.

(e) EXCEPTION IN CASE OF EMERGENCY ACQUISITION.—This section shall not apply with respect to the closing of a branch of a national bank pursuant to an order of—

(1) the Comptroller of the Currency placing the national bank in receivership; or

(2) the Comptroller of the Currency or the Federal Deposit Insurance Corporation authorizing another company to acquire (as such term is defined in section 13(f)(8)(E) of the Federal Deposit Insurance Act) control of such bank in connection with a transaction under section 13(f) of the Federal Deposit Insurance Act if the closing of such branch is necessary to facilitate such acquisition.

(f) DEFINITIONS.—

(1) BRANCH.—For purposes of this section, the term "branch" has the meaning given to such term by section 5155(f) of the Revised Statutes.

(2) DEPOSITORY INSTITUTION.—For purposes of this section, the term "depository institution" has the meaning given to such term in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act.

(g) TECHNICAL AND CONFORMING AMENDMENT.—Section 5155 of the Revised Statutes (12 U.S.C. 36) is amended by adding at the end thereof the following new subsection:

"(i) BRANCH CLOSING.—No branch of a national banking association may be closed unless notice of such closing has been provided to the Comptroller of the Currency and to customers of such branch in accordance with section 232 of the Bank and Thrift Branch Closure Act of 1988.".

SEC. 432. NOTICE REQUIREMENTS FOR THRIFT INSTITUTIONS.

The Home Owners' Loan Act of 1933 (12 U.S.C. 1461 et seq.) is amended by redesignating section 11 as section 12 and by inserting after section 10 the following new section:

"SEC. 11. ASSOCIATION BRANCH CLOSINGS.

"(a) NOTICE TO BOARD REQUIRED.—In the case of any association which proposes to close any branch of such association, the association shall provide written notice of such proposed action to the Board not less than 90 days and not more than 180 days before such action is to occur.

"(b) NOTICE TO CUSTOMERS.—

"(1) NOTICE REQUIRED.—In the case of any association which proposes to close any branch of such association, the association shall provide—

"(A) notice of such proposed action to customers of such branch in the manner described in paragraph (2); and

"(B) the mailing address of the Board and a statement that comments on the proposed closing of such branch may be mailed to the Board.

"(2) METHOD.—Any notice required to be provided under paragraph (1) shall be provided in the following manner:

"(A) POSTED ON BRANCH PREMISES.—A general notice of the plan to close a branch and the date such action is planned shall be posted in

a conspicuous place on the premises of such branch not later than the date on which written notice is provided to the Board pursuant to subsection (a).

"(B) Notice in Statement of Account.—Notice of such plan shall be inserted in at least 1 of any periodic statements of account which are mailed—

"(i) to any person who maintains an account at such branch; and

"(ii) during the period beginning 180 days before the date such action is to occur and ending 90 days before such date.

"(c) Subsequent Information Requirements.—Unless no comments or only frivolous comments are received by the Board with respect to any plan to close a branch of an association before the end of the 30-day period beginning on the date written notice is provided by the association of such proposed action to the Board under subsection (a), the Board shall require such association to provide—

"(1) a detailed statement of the reasons for the decision to close such branch;

"(2) any statistical or other information in support of such reasons;

"(3) a financial analysis of deposit activity at such branch during the 3-year period ending on the date of such notice (including the number of accounts, total dollar amounts of deposits, and profits and losses on such deposit activity), and a projection of the deposit activity that could be expected at such branch in the future if the branch were to remain open;

"(4) a financial analysis of loan activity at such branch during the 3-year period ending on the date of such notice (including profits and losses on such loan activity), and a projection of the loan activity that could be expected at such branch in the future if the branch were to remain open;

"(5) a detailed map of the area served by the branch showing the location of all other branches of depository institutions located within such area and the distance of each such branch from the branch proposed to be closed; and

"(6) a description of, and the location of, any limited or full-service facility which the association plans to establish in such area or which the association has reason ~~to believe~~ another depository institution plans to establish in such area.

"(d) ACTION REQUIRED OF BOARD.—

"(1) DETERMINATION ON AVAILABILITY OF SERVICES.—Whenever the Board receives any notice under subsection (a) with respect to any plan to close a branch of an association, the Board shall determine whether the closing of such branch will result in a significant reduction in the availability of services of depository institutions in the area in which such branch is located.

"(2) ASSISTANCE TO COMMUNITY.—If the Board determines that the closing of a branch will result in a significant reduction in the availability of services of depository institutions in the area in which such branch is located, the Board shall consult with leaders in the affected area, and with such other depository institutions as the Board may determine to be appropriate, to explore the feasibility of replacing such branch with adequate banking facilities, including the establishment of a community development credit union.

"(e) EXCEPTION IN CASE OF EMERGENCY ACQUISITION.—This section shall not apply with respect to the closing of a branch of an association pursuant to an order of—

"(1) the Board placing the association in receivership; or

"(2) the Board or the Federal Savings and Loan Insurance Corporation authorizing another company to

acquire (as such term is defined in section 13(f)(8)(E) of the Federal Deposit Insurance Act) control of such association in connection with a transaction under section 408(m) of the National Housing Act if the closing of such branch is necessary to facilitate such acquisition.

"(f) Definitions.—

"(1) Branch defined.—For purposes of this section, the term 'branch' has the same meaning with respect to associations as such term has under section 5155(f) of the Revised Statutes with respect to national banking associations.

"(2) Depository institution.—For purposes of this section, the term 'depository institution' has the meaning given to such term in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act.".

SEC. 434. EFFECTIVE DATE.

This subtitle and the amendments made by this subtitle shall take effect at the end of the 90-day period beginning on the date of the enactment of this Act.

Subtitle E—Truth in Savings

SEC. 441. SHORT TITLE.

This subtitle may be cited as the "Truth in Savings Act".

SEC. 442. FINDINGS AND PURPOSE.

(a) FINDINGS.—The Congress hereby finds that economic stability would be enhanced, competition between depository institutions would be improved, and the ability of the consumer to make informed decisions regarding deposit accounts would be strengthened if there was uniformity in the disclosure of terms and conditions on which interest is paid and fees are assessed in connection with such accounts.

(b) PURPOSE.—It is the purpose of this subtitle to require the clear and uniform disclosure of—

(1) the rates of interest which are payable on deposit accounts by depository institutions; and

(2) the fees that are assessable against deposit accounts,

so that consumers can make a meaningful comparison between the competing claims of depository institutions with regard to deposit accounts.

SEC. 443. DISCLOSURE OF INTEREST RATES AND TERMS OF ACCOUNTS.

(a) IN GENERAL.—Except as provided in subsection (b), each advertisement, announcement, or solicitation initiated by any depository institution relating to any demand or interest-bearing account which includes any reference to a specific rate of interest payable on amounts deposited in such account, or to a specific yield or rate of earnings on amounts

so deposited, shall state the following information, to the extent applicable, in a clear and conspicuous manner:

(1) The annual percentage yield (which shall be noted in greater prominence than any other stated rate).

(2) The period during which such annual percentage yield is in effect.

(3) All minimum account balance and time requirements which must be met in order to earn the advertised yield (and, in the case of accounts for which more than 1 yield is stated, each annual percentage yield and the account minimum balance requirement associated with each such yield shall be in close proximity and have equal prominence).

(4) The minimum amount of the initial deposit which is required to open the account in order to obtain the yield advertised, if such minimum amount is greater than the minimum balance necessary to earn the advertised yield.

(5) The annual rates of simple interest.

(6) A statement that regular fees or other conditions could reduce the yield.

(7) A statement that an interest penalty is required for early withdrawal.

(8) In the case of a certificate of deposit or other account for which the stated date of maturity is less than 1 year, a statement of the effective percentage yield on the date of maturity.

(b) BROADCAST AND ELECTRONIC MEDIA AND OUTDOOR ADVERTISING EXCEPTION.—The Board may, by regulation, exempt advertisements, announcements, or solicitations made by any broadcast or electronic medium or outdoor advertising display not on the premises of the depository institution from any disclosure requirements described in paragraph (4), (5), or (6) of subsection (a) if the Board finds that any such disclosure would be unnecessarily burdensome.

(c) MISLEADING DESCRIPTIONS OF FREE OR NO-COST ACCOUNTS PROHIBITED.—No advertisement, announcement, or solicitation made by any depository institution may refer to or describe an account as a free or no-cost account if—

(1) in order to avoid fees or service charges for any period—

(A) a minimum balance must be maintained in the account during such period; or

(B) the number of transactions during such period may not exceed a maximum number; or

(2) any regular service or transaction fee is imposed.

(d) Misleading or Inaccurate Advertisements, Etc., Prohibited.—*No depository institution shall make any advertisement, announcement, or solicitation relating to a deposit account that is inaccurate or misleading or that misrepresents its deposit contracts.*

SEC. 444. ACCOUNT SCHEDULE.

(a) In General.—*Each depository institution shall maintain a schedule of fees, charges, interest rates, and terms and conditions applicable to each class of accounts offered by the depository institution, in accordance with the requirements of this section and regulations which the Board shall prescribe. The Board shall specify, in regulations, which fees, charges, penalties, terms, conditions, and account restrictions must be included in a schedule required under this subsection. A depository institution need not include in such schedule any information not specified in such regulation.*

(b) Information on Fees and Charges.—*The schedule required under subsection (a) with respect to any account shall contain the following information:*

(1) A description of all fees, periodic service charges, and penalties which may be charged or assessed against the account (or against the account holder in connection with such account), the amount of any such fees, charge, or penalty (or the method by

which such amount will be calculated), and the conditions under which any such amount will be assessed.

(2) All minimum balance requirements that affect fees, charges, and penalties, including a clear description of how each such minimum balance is calculated.

(3) Any minimum amount required with respect to the initial deposit in order to open the account.

(c) INFORMATION ON INTEREST RATES.—The schedule required under subsection (a) with respect to any account shall include the following information:

(1) Any annual percentage yield.

(2) The period during which any such annual percentage yield will be in effect.

(3) Any annual rate of simple interest.

(4) The frequency with which interest will be compounded and credited.

(5) A clear description of the method used to determine the balance on which interest is paid.

(6) In the case of a certificate of deposit or other account for which the stated date of maturity is less than 1 year, a statement of the effective percentage yield on the date of maturity.

(7) The information described in paragraphs (1) through (4) with respect to any period after the end of the period referred to in paragraph (2) (or the method

for computing any information described in any such paragraph), if applicable.

(8) Any minimum balance which must be maintained to earn the rates and obtain the yields disclosed pursuant to this subsection and a clear description of how any such minimum balance is calculated.

(9) A clear description of any minimum time requirement which must be met in order to obtain the yields disclosed pursuant to this subsection and any information described in paragraph (1), (2), (3), or (4) that will apply if any time requirement is not met.

(10) A statement, if applicable, that any interest which has accrued but has not been credited to an account at the time of a withdrawal from the account will not be paid by the depository institution or credited to the account by reason of such withdrawal.

(11) Any provision or requirement relating to nonpayment of interest, including any charge or penalty for early withdrawal, and the conditions under which any such charge or penalty may be assessed.

(d) OTHER INFORMATION.—The schedule required under subsection (a) shall include such other disclosures as the Board may determine to be necessary to allow consumers to understand and compare accounts, including frequency of

interest rate adjustments, account restrictions, and renewal policies for time accounts.

(e) Style and Format.—Schedules required under subsection (a) shall be written in clear and plain language and be presented in a format designed to allow consumers to readily understand the terms of the accounts offered.

SEC. 445. DISCLOSURE REQUIREMENTS FOR CERTAIN ACCOUNTS.

The Board shall require, in regulations which the Board shall prescribe, such modification in the disclosure requirements under this subtitle relating to annual percentage yield as may be necessary to carry out the purposes of this subtitle in the case of—

(1) accounts with respect to which determination of annual percentage yield is based on an annual rate of interest that is guaranteed for a period of less than 1 year;

(2) variable rate accounts;

(3) accounts which, pursuant to law, do not guarantee payment of a stated rate; and

(4) multiple rate accounts.

SEC. 446. DISTRIBUTION OF SCHEDULES.

(a) In General.—A schedule required under section 444 for an appropriate account shall be—

(1) included in any regularly scheduled mailing to holders of that account which occurs not more than 90 days after the effective date of the initial regulations prescribed by the Board under this subtitle, unless the depository institution has provided, before such effective date, a disclosure which meets the requirements of section 444;

(2) made available to any person upon request; and

(3) provided to any potential customer before an account is opened or a service is rendered.

(b) DISTRIBUTION IN CASE OF CERTAIN INITIAL DEPOSITS.—If—

(1) a depositor is not physically present at an office of a depository institution at the time an initial deposit is accepted with respect to an account established by or for such person; and

(2) the schedule required under section 444(a) has not been furnished previously to such depositor,

the depository institution shall mail the schedule to the depositor at the address shown on the records of the depository institution for such account no later than 10 days after the date of the initial deposit.

(c) DISTRIBUTION OF NOTICE OF CERTAIN CHANGES.—If—

(1) any change is made in any term or condition which is required to be disclosed in the schedule required under section 444(a) with respect to any account; and

(2) the change may reduce the yield or adversely affect any holder of the account,

all account holders who may be affected by such change shall be notified and provided with a description of the change by mail at least 30 days before the change takes effect.

(d) DISTRIBUTION IN CASE OF ACCOUNTS ESTABLISHED BY MORE THAN 1 INDIVIDUAL OR BY A GROUP.—If an account is established by more than 1 individual or for a person other than an individual, any distribution described in this section with respect to such account meets the requirements of this section if the distribution is made to 1 of the individuals who established the account or 1 individual representative of the person on whose behalf such account was established.

SEC. 447. PAYMENT OF INTEREST.

(a) CALCULATED ON FULL AMOUNT OF PRINCIPAL.—The amount of interest accruing on an interest-bearing account at any depository institution shall be calculated by such institution on the full amount of principal in the account for the stated calculation period at the rate or rates of interest disclosed pursuant to this subtitle.

(b) NO PARTICULAR METHOD OF COMPOUNDING INTEREST REQUIRED.—Subsection (a) shall not be construed as prohibiting or requiring the use of any particular method of compounding or crediting of interest.

SEC. 448. REGULATIONS.

(a) IN GENERAL.—Not later than 1 year after the date of the enactment of this subtitle, the Board, after consultation with each agency referred to in section 449(a) and public notice and opportunity for comment, shall prescribe regulations to carry out the purpose and provisions of this subtitle. The regulations so prescribed may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of accounts as, in the judgment of the Board, are necessary or proper to carry out the purposes of this subtitle, to prevent circumvention or evasion of the requirements of this subtitle, or to facilitate compliance with the requirements of this subtitle.

(b) MODEL FORMS AND CLAUSES.—

(1) IN GENERAL.—The Board shall publish model forms and clauses for common disclosures to facilitate compliance with this subtitle. In devising such forms, the Board shall consider the use by depository institutions of data processing or similar automated machines.

(2) USE OF FORMS AND CLAUSES DEEMED IN COMPLIANCE.—Nothing in this subtitle may be construed to require a depository institution to use any such model form or clause prescribed by the Board under this subsection. A depository institution shall be deemed to be in compliance with the disclosure provisions of this subtitle if the depository institution—

(A) uses any appropriate model form or clause as published by the Board; or

(B) uses any such model form or clause and changes it by—

(i) deleting any information which is not required by this subtitle; or

(ii) rearranging the format,

if in making such deletion or rearranging the format, the depository institution does not affect the substance, clarity, or meaningful sequence of the disclosure.

(3) PUBLIC NOTICE AND OPPORTUNITY FOR COMMENT.—Model disclosure forms and clauses shall be adopted by the Board after duly given notice in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5, United States Code.

SEC. 449. ADMINISTRATIVE ENFORCEMENT.

(a) In General.—Compliance with the requirements imposed under this subtitle shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act, in the case of—

(A) national banks, by the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

(C) depository institutions described in clause (i), (ii), or (iii) of section 19(b)(1)(A) of the Federal Reserve Act (other than member banks of the Federal Reserve System) by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 5(d) of the Home Owners' Loan Act of 1933, section 407 of the National Housing Act, and sections 6(i) and 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation) in the case of depository institutions described in clause (v) or (vi) of section 19(b)(1)(A) of the Federal Reserve Act; and

(3) the Federal Credit Union Act, by the National Credit Union Administration Board in the case of

depository institutions described in clause (iv) of section 19(b)(1)(A) of the Federal Reserve Act.

(b) ADDITIONAL ENFORCEMENT POWERS.—

(1) VIOLATION OF THIS SUBTITLE TREATED AS VIOLATION OF OTHER ACTS.—For purposes of the exercise by any agency referred to in subsection (a) of such agency's powers under any Act referred to in such subsection, a violation of a requirement imposed under this subtitle shall be deemed to be a violation of a requirement imposed under that Act.

(2) ENFORCEMENT AUTHORITY UNDER OTHER ACTS.—In addition to the powers of any agency referred to in subsection (a) under any provision of law specifically referred to in such subsection, each such agency may exercise, for purposes of enforcing compliance with any requirement imposed under this subtitle, any other authority conferred on such agency by law.

(c) REGULATIONS BY AGENCIES OTHER THAN THE BOARD.—The authority of the Board to issue regulations under this subtitle does not impair the authority of any other agency referred to in subsection (a) to make rules regarding its own procedures in enforcing compliance with the requirements imposed under this subtitle.

SEC. 468. CIVIL LIABILITY.

(a) CIVIL LIABILITY.—Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under this subtitle or any regulation prescribed under this subtitle with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action, such additional amount as the court may allow, except that the liability under this subparagraph shall not be less than $100 nor greater than $1,000; or

(B) in the case of a class action, such amount as the court may allow, except that—

(i) as to each member of the class, no minimum recovery shall be applicable; and

(ii) the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of $500,000 or 1 percent of the net worth of the depository institution involved; and

(3) in the case of any successful action to enforce any liability under paragraph (1) or (2), the costs of

the action, together with a reasonable attorney's fee as determined by the court.

(b) CLASS ACTION AWARDS.—In determining the amount of any award in any class action, the court shall consider, among other relevant factors—

(1) the amount of any actual damages awarded;

(2) the frequency and persistence of failures of compliance;

(3) the resources of the depository institution;

(4) the number of persons adversely affected; and

(5) the extent to which the failure of compliance was intentional.

(c) BONA FIDE ERRORS.—

(1) GENERAL RULE.—A depository institution may not be held liable in any action brought under this section for a violation of this subtitle if the depository institution demonstrates by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error, notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.

(2) EXAMPLES.—Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a depository institu-

tion's obligation under this subtitle is not a bona fide error.

(d) JURISDICTION.—Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year after the date of the occurrence of the violation involved.

(e) RELIANCE ON BOARD RULINGS.—No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, notwithstanding the fact that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(f) NOTIFICATION OF AND ADJUSTMENT FOR ERRORS.—A depository institution shall not be liable under this section or section 449 for any failure to comply with any requirement imposed under this subtitle with respect to any account if—

(1) before—

(A) the end of the 60-day period beginning on the date on which the depository institution discovered the failure to comply;

(B) any action is instituted against the depository institution by the account holder under

this section with respect to such failure to comply; and

(C) any written notice of such failure to comply is received by the depository institution from the account holder,

the depository institution notifies the account holder of the failure of such institution to comply with such requirement; and

(2) the depository institution makes such adjustments as may be necessary with respect to such account to ensure that—

(A) the account holder will not be liable for any amount in excess of the amount actually disclosed with respect to any fee or charge;

(B) the account holder will not be liable for any fee or charge imposed under any condition not actually disclosed; and

(C) interest on amounts in such account will accrue at the annual percentage yield, and under the conditions, actually disclosed (and credit will be provided for interest already accrued at a different annual percentage yield and under different conditions than the yield or conditions disclosed).

(g) MULTIPLE INTERESTS IN 1 ACCOUNT.—If more than 1 person holds an interest in any account—

(1) the minimum and maximum amounts of liability under subsection (a)(2)(A) for any failure to comply with the requirements of this subtitle shall apply with respect to such account; and

(2) the court shall determine the manner in which the amount of any such liability with respect to such account shall be distributed among such persons.

(h) CONTINUING FAILURE TO DISCLOSE.—

(1) CERTAIN CONTINUING FAILURES TREATED AS 1 VIOLATION.—Except as provided in paragraph (2), the continuing failure of any depository institution to disclose any particular term required to be disclosed under this subtitle with respect to a particular account shall be treated as a single violation for purposes of determining the amount of any liability of such institution under subsection (a) for such failure to disclose.

(2) SUBSEQUENT FAILURE TO DISCLOSE.—The continuing failure of any depository institution to disclose any particular term required to be disclosed under this subtitle with respect to a particular account after judgment has been rendered in favor of the account holder in connection with a prior failure to disclose such term with respect to such account shall be treated as a subsequent violation for purposes of determining liability under subsection (a).

(3) COORDINATION WITH SECTION 449.—This subsection shall not limit or otherwise affect the enforcement power under section 449 of any agency referred to in subsection (a) of such section.

SEC. 451. CREDIT UNIONS.

(a) IN GENERAL.—No regulation prescribed by the Board under this subtitle shall apply directly with respect to any depository institution described in clause (iv) of section 19(b)(1)(A) of the Federal Reserve Act.

(b) REGULATIONS PRESCRIBED BY THE NCUA.—Within 90 days of the effective date of any regulation prescribed by the Board under this subtitle, the National Credit Union Administration Board shall prescribe a regulation substantially similar to the regulation prescribed by the Board taking into account the unique nature of credit unions and the limitations under which they may pay dividends on member accounts.

SEC. 452. EFFECT ON STATE LAW.

This subtitle does not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with terms of deposit accounts, except to the extent that those laws are inconsistent with the provisions of this subtitle, and then only to the extent of the inconsistency.

SEC. 453. DEFINITIONS.

For the purposes of this subtitle—

(1) DEPOSITORY INSTITUTION.—The term "depository institution" has the meaning given such term in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act.

(2) BOARD.—The term "Board" means the Board of Governors of the Federal Reserve System.

(3) ACCOUNT.—The term "account" means any account offered to 1 or more individuals or an unincorporated nonbusiness association of individuals by a depository institution into which a customer deposits funds, including demand accounts, time accounts, negotiable order of withdrawal accounts, and share draft accounts.

(4) INTEREST.—The term "interest" includes dividends paid with respect to share draft accounts which are accounts within the meaning of paragraph (3).

(5) MULTIPLE RATE ACCOUNT.—The term "multiple rate account" means any account that has 2 or more annual rates of simple interest which take effect in succeeding periods and which are known at the time of disclosure.

(6) ANNUAL PERCENTAGE YIELD.—The term "annual percentage yield" shall be equal to the total amount of interest that would be received on a $100

deposit under the terms described in paragraphs (3) and (4) of section 444(c) over a year, expressed as a percentage calculated by a method which shall be prescribed by the Board in regulations.

Subtitle F—Home Equity Loan Requirements

SEC. 461. SHORT TITLE.

This subtitle may be cited as the "Home Equity Loan Consumer Protection Act of 1988".

SEC. 462. DISCLOSURE AND ADVERTISING REQUIREMENTS FOR HOME EQUITY LOANS.

(a) Disclosure Requirements.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 127 the following new section:

"SEC. 127A. DISCLOSURE REQUIREMENTS FOR OPEN END CONSUMER CREDIT PLANS SECURED BY THE CONSUMER'S PRINCIPAL DWELLING.

"(a) Application Disclosures.—In the case of any open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling, the creditor shall make the following disclosures in accordance with subsection (b):

"(1) Fixed annual percentage rate.—Each annual percentage rate imposed in connection with ex-

tensions of credit under the plan and a statement that such rate does not include costs other than interest.

"(2) VARIABLE PERCENTAGE RATE.—In the case of a plan which provides for variable rates of interest on credit extended under the plan—

"(A) a description of the manner in which such rate will be computed and a statement that such rate does not include costs other than interest;

"(B) a description of the manner in which any changes in the annual percentage rate will be made, including—

"(i) any negative amortization and interest rate carryover;

"(ii) the timing of any such changes;

"(iii) any index or margin to which such changes in the rate are related; and

"(iv) a source of information about any such index;

"(C) if an initial annual percentage rate is offered which is not based on an index—

"(i) a statement of such rate and the period of time such initial rate will be in effect; and

"(ii) a statement that such rate does not include costs other than interest;

"(D) a statement that the consumer should ask about the current index value and interest rate;

"(E) a statement of the maximum amount by which the annual percentage rate may change in any 1-year period or a statement that no such limit exists;

"(F) a statement of the maximum annual percentage rate that may be imposed at any time under the plan;

"(G) subject to subsection (b)(3), a table, based on a $10,000 extension of credit, showing how the annual percentage rate and the minimum periodic payment amount under each repayment option of the plan would have been affected during the preceding 15-year period by changes in any index used to compute such rate;

"(H) a statement of—

"(i) the maximum annual percentage rate which may be imposed under each repayment option of the plan;

"(ii) the minimum amount of any periodic payment which may be required, based

on a $10,000 outstanding balance, under each such option when such maximum annual percentage rate is in effect; and

"(iii) the earliest date by which such maximum annual interest rate may be imposed; and

"(I) a statement that interest rate information will be provided on or with each periodic statement.

"(3) OTHER FEES IMPOSED BY THE CREDITOR.—An itemization of any fees imposed by the creditor in connection with the availability or use of credit under such plan, including annual fees, application fees, transaction fees, and closing costs (including costs commonly described as 'points'), and the time when such fees are payable.

"(4) ESTIMATES OF FEES WHICH MAY BE IMPOSED BY THIRD PARTIES.—

"(A) AGGREGATE AMOUNT.—An estimate, based on the creditor's experience with such plans and stated as a single amount or as a reasonable range, of the aggregate amount of additional fees that may be imposed by third parties (such as governmental authorities, appraisers, and attor-

neys) in connection with opening an account under the plan.

"(B) STATEMENT OF AVAILABILITY.—A statement that the consumer may ask the creditor for a good faith estimate by the creditor of the fees that may be imposed by third parties.

"(5) STATEMENT OF RISK OF LOSS OF DWELLING.—A statement that—

"(A) any extension of credit under the plan is secured by the consumer's dwelling; and

"(B) in the event of any default, the consumer risks the loss of the dwelling.

"(6) CONDITIONS TO WHICH DISCLOSED TERMS ARE SUBJECT.—

"(A) PERIOD DURING WHICH SUCH TERMS ARE AVAILABLE.—A clear and conspicuous statement—

"(i) of the time by which an application must be submitted to obtain the terms disclosed; or

"(ii) if applicable, that the terms are subject to change.

"(B) RIGHT OF REFUSAL IF CERTAIN TERMS CHANGE.—A statement that—

"(i) the consumer may elect not to enter into an agreement to open an account under the plan if any term changes (other than a change contemplated by a variable feature of the plan) before any such agreement is final; and

"(ii) if the consumer makes an election described in clause (i), the consumer is entitled to a refund of all fees paid in connection with the application.

"(C) RETENTION OF INFORMATION.—A statement that the consumer should make or otherwise retain a copy of information disclosed under this subparagraph.

"(7) RIGHTS OF CREDITOR WITH RESPECT TO EXTENSIONS OF CREDIT.—A statement that—

"(A) under certain conditions, the creditor may terminate any account under the plan and require immediate repayment of any outstanding balance, prohibit any additional extension of credit to the account, or reduce the credit limit applicable to the account; and

"(B) the consumer may receive, upon request, more specific information about the condi-

tions under which the creditor may take any action described in subparagraph (A).

"(8) REPAYMENT OPTIONS AND MINIMUM PERIODIC PAYMENTS.—The repayment options under the plan, including—

"(A) if applicable, any differences in repayment options with regard to—

"(i) any period during which additional extensions of credit may be obtained; and

"(ii) any period during which repayment is required to be made and no additional extensions of credit may be obtained;

"(B) the length of any repayment period, including any differences in the length of any repayment period with regard to the periods described in clauses (i) and (ii) of subparagraph (A); and

"(C) an explanation of how the amount of any minimum monthly or periodic payment will be determined under each such option, including any differences in the determination of any such amount with regard to the periods described in clauses (i) and (ii) of subparagraph (A).

"(9) EXAMPLE OF MINIMUM PAYMENTS AND MAXIMUM REPAYMENT PERIOD.—An example, based

on a $10,000 outstanding balance and the interest rate (other than a rate not based on the index under the plan) which is, or was recently, in effect under such plan, showing the minimum monthly or periodic payment, and the time it would take to repay the entire $10,000 if the consumer paid only the minimum periodic payments and obtained no additional extensions of credit.

"(10) STATEMENT CONCERNING BALLOON PAYMENTS.—If, under any repayment option of the plan, the payment of not more than the minimum periodic payments required under such option over the length of the repayment period—

"(A) would not repay any of the principal balance; or

"(B) would repay less than the outstanding balance by the end of such period,

as the case may be, a statement of such fact, including an explicit statement that at the end of such repayment period a balloon payment (as defined in section 147(f)) would result which would be required to be paid in full at that time.

"(11) NEGATIVE AMORTIZATION.—If applicable, a statement that—

"(A) any limitation in the plan on the amount of any increase in the minimum payments may result in negative amortization;

"(B) negative amortization increases the outstanding principal balance of the account; and

"(C) negative amortization reduces the consumer's equity in the consumer's dwelling.

"(12) LIMITATIONS AND MINIMUM AMOUNT REQUIREMENTS ON EXTENSIONS OF CREDIT.—

"(A) NUMBER AND DOLLAR AMOUNT LIMITATIONS.—Any limitation contained in the plan on the number of extensions of credit and the amount of credit which may be obtained during any month or other defined time period.

"(B) MINIMUM BALANCE AND OTHER TRANSACTION AMOUNT REQUIREMENTS.—Any requirement which establishes a minimum amount for—

"(i) the initial extension of credit to an account under the plan;

"(ii) any subsequent extension of credit to an account under the plan; or

"(iii) any outstanding balance of an account under the plan.

"(13) Statement regarding consultation of tax advisor.—A statement that the consumer should consult a tax adviser regarding the deductibility of interest and charges under the plan.

"(14) Disclosure requirements established by board.—Any other term which the Board requires, in regulations, to be disclosed.

"(b) Time and Form of Disclosures.—

"(1) Time of disclosure.—

"(A) In general.—The disclosures required under subsection (a) with respect to any open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling and the pamphlet required under subsection (e) shall be provided to any consumer at the time the creditor distributes an application to establish an account under such plan to such consumer.

"(B) Telephone, publications, and 3d party applications.—In the case of telephone applications, applications contained in magazines or other publications, or applications provided by a third party, the disclosures required under subsection (a) and the pamphlet required under subsection (e) shall be provided by the creditor before

the end of the 3-day period beginning on the date the creditor receives a completed application from a consumer.

"(2) FORM.—

"(A) IN GENERAL.—Except as provided in paragraph (1)(B), the disclosures required under subsection (a) shall be provided on or with any application to establish an account under an open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling.

"(B) SEGREGATION OF REQUIRED DISCLOSURES FROM OTHER INFORMATION.—The disclosures required under subsection (a) shall be conspicuously segregated from all other terms, data, or additional information provided in connection with the application, either by grouping the disclosures separately on the application form or by providing the disclosures on a separate form, in accordance with regulations of the Board.

"(C) PRECEDENCE OF CERTAIN INFORMATION.—The disclosures required by paragraphs (5), (6), and (7) of subsection (a) shall precede all of the other required disclosures.

"(D) SPECIAL PROVISION RELATING TO VARIABLE INTEREST RATE INFORMATION.—Whether or not the disclosures required under subsection (a) are provided on the application form, the variable rate information described in subsection (a)(2) may be provided separately from the other information required to be disclosed.

"(3) REQUIREMENT FOR HISTORICAL TABLE.—In preparing the table required under subsection (a)(2)(G), the creditor shall consistently select one rate of interest for each year and the manner of selecting the rate from year to year shall be consistent with the plan

"(c) 3D PARTY APPLICATIONS.—In the case of an application to open an account under any open end consumer credit plan described in subsection (a) which is provided to a consumer by any person other than the creditor—

"(1) such person shall provide such consumer with—

"(A) the disclosures required under subsection (a) with respect to such plan, in accordance with subsection (b); and

"(B) the pamphlet required under subsection (e); or

"(2) if such person cannot provide specific terms about the plan because specific information about the plan terms is not available, no nonrefundable fee may be imposed in connection with such application before the end of the 3-day period beginning on the date the consumer receives the disclosures required under subsection (a) with respect to the application.

"(d) PRINCIPAL DWELLING DEFINED.—For purposes of this section and sections 137 and 147, the term 'principal dwelling' includes any second or vacation home of the consumer.

"(e) PAMPHLET.—In addition to the disclosures required under subsection (a) with respect to an application to open an account under any open end consumer credit plan described in such subsection, the creditor or other person providing such disclosures to the consumer shall provide—

"(1) a pamphlet published by the Board pursuant to section 464 of the Home Equity Consumer Protection Act of 1988; or

"(2) any pamphlet which provides substantially similar information to the information described in such section, as determined by the Board.".

(b) ADDITIONAL DISCLOSURES WHEN ACCOUNT IS OPENED.—Section 127(a) of the Truth in Lending Act (15

U.S.C. 1637(a)) is amended by adding at the end thereof the following new paragraph:

"(8) In the case of any account under an open end consumer credit plan which provides for any extension of credit which is secured by the consumer's principal dwelling, any information which—

"(A) is required to be disclosed under section 127A(a); and

"(B) the Board determines is not described in any other paragraph of this subsection.".

(c) ADVERTISING REQUIREMENTS.—Chapter 3 of the Truth in Lending Act (15 U.S.C. 1661 et seq.) is amended by adding at the end thereof the following new section:

"SEC. 147. ADVERTISING OF OPEN END CONSUMER CREDIT PLANS SECURED BY THE CONSUMER'S PRINCIPAL DWELLING.

"(a) IN GENERAL.—If any advertisement to aid, promote, or assist, directly or indirectly, the extension of consumer credit through an open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling states, affirmatively or negatively, any of the specific terms of the plan, including any periodic payment amount required under such plan, such advertisement shall also clearly and conspicuously set forth the following

information, in such form and manner as the Board may require:

"(1) LOAN FEES AND OPENING COST ESTIMATES.—Any loan fee the amount of which is determined as a percentage of the credit limit applicable to an account under the plan and an estimate of the aggregate amount of other fees for opening the account, based on the creditor's experience with the plan and stated as a single amount or as a reasonable range.

"(2) PERIODIC RATES.—In any case in which periodic rates may be used to compute the finance charge, the periodic rates expressed as an annual percentage rate.

"(3) HIGHEST ANNUAL PERCENTAGE RATE.—The highest annual percentage rate which may be imposed under the plan.

"(4) OTHER INFORMATION.—Any other information the Board may by regulation require.

"(b) TAX DEDUCTIBILITY.—If any advertisement described in subsection (a) contains a statement that any interest expense incurred with respect to the plan is or may be tax deductible, the advertisement shall not be misleading with respect to such deductibility.

"(c) CERTAIN TERMS PROHIBITED.—No advertisement described in subsection (a) with respect to any home

equity account may refer to such loan as 'free money' or use other terms determined by the Board by regulation to be misleading.

"(d) DISCOUNTED INITIAL RATE.—

"(1) IN GENERAL.—If any advertisement described in subsection (a) includes an initial annual percentage rate that is not determined by the index or formula used to make later interest rate adjustments, the advertisement shall also state with equal prominence the current annual percentage rate that would have been applied using the index or formula if such initial rate had not been offered.

"(2) QUOTED RATE MUST BE REASONABLY CURRENT.—The annual percentage rate required to be disclosed under paragraph (1) rate must be current as of a reasonable time given the media involved.

"(3) PERIOD DURING WHICH INITIAL RATE IS IN EFFECT.—Any advertisement to which paragraph (1) applies shall also state the period of time during which the initial annual percentage rate referred to in such paragraph will be in effect.

"(e) BALLOON PAYMENT.—If any advertisement described in subsection (a) contains a statement regarding the minimum monthly payment under the plan, the advertise-

ment shall also disclose, if applicable, the fact that the plan includes a balloon payment.

"(f) BALLOON PAYMENT DEFINED.—For purposes of this section and section 127A, the term 'balloon payment' means, with respect to any open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling, any repayment option under which—

"(1) the account holder is required to repay the entire amount of any outstanding balance as of a specified date or at the end of a specified period of time, as determined in accordance with the terms of the agreement pursuant to which such credit is extended; and

"(2) the aggregate amount of the minimum periodic payments required would not fully amortize such outstanding balance by such date or at the end of such period.".

(d) TECHNICAL AND CONFORMING AMENDMENTS.—Section 122(b) of the Truth in Lending Act (15 U.S.C. 1632(b)) is amended by striking out "section 128(b)(1)" and inserting in lieu thereof "sections 127A(b)(3) and 128(b)(1)".

SEC. 463. HOME EQUITY PROTECTIONS.

Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by adding at the end thereof the following new section:

"SEC. 137. HOME EQUITY PLANS.

"(a) INDEX REQUIREMENT.—In the case of extensions of credit under an open end consumer credit plan which are subject to a variable rate and are secured by a consumer's principal dwelling, the index or other rate of interest to which changes in the annual percentage rate are related shall be based on an index or rate of interest which is publicly available and is not under the control of the creditor.

"(b) GROUNDS FOR ACCELERATION OF OUTSTANDING BALANCE.—A creditor may not unilaterally terminate any account under an open end consumer credit plan under which extensions of credit are secured by a consumer's principal dwelling and require the immediate repayment of any outstanding balance at such time, except in the case of—

"(1) fraud or material misrepresentation on the part of the consumer in connection with the account;

"(2) failure by the consumer to meet the repayment terms of the agreement for any outstanding balance; or

"(3) any other action or failure to act by the consumer which adversely affects the creditor's security for the account or any right of the creditor in such security.

"(c) CHANGE IN TERMS.—

"(1) IN GENERAL.—No open end consumer credit plan under which extensions of credit are secured by a

consumer's principal dwelling may contain a provision which permits a creditor to change unilaterally any term required to be disclosed under section 127A(a) or any other term, except a change in insignificant terms such as the address of the creditor for billing purposes.

"(2) CERTAIN CHANGES NOT PRECLUDED.—Notwithstanding the provisions of subsection (1), a creditor may make any of the following changes:

"(A) Change the index and margin applicable to extensions of credit under such plan if the index used by the creditor is no longer available and the substitute index and margin would result in a substantially similar interest rate.

"(B) Prohibit additional extensions of credit or reduce the credit limit applicable to an account under the plan during any period in which the value of the consumer's principal dwelling which secures any outstanding balance is significantly less than the original appraisal value of the dwelling.

"(C) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which the creditor has reason to believe that the consumer will be unable to comply with the repayment requirements of the

account due to a material change in the consumer's financial circumstances.

"(D) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which the consumer is in default with respect to any material obligation of the consumer under the agreement.

"(E) Prohibit additional extensions of credit or reduce the credit limit applicable to the account during any period in which—

"(i) the creditor is precluded by government action from imposing the annual percentage rate provided for in the account agreement; or

"(ii) any government action is in effect which adversely affects the priority of the creditor's security interest in the account to the extent that the value of the creditor's secured interest in the property is less than 120 percent of the amount of the credit limit applicable to the account.

"(F) Any change that will benefit the consumer.

"(3) MATERIAL OBLIGATIONS.—Upon the request of the consumer and at the time an agreement is

entered into by a consumer to open an account under an open end consumer credit plan under which extensions of credit are secured by the consumer's principal dwelling, the consumer shall be given a list of the categories of contract obligations which are deemed by the creditor to be material obligations of the consumer under the agreement for purposes of paragraph (2)(D).

"(4) CONSUMER BENEFIT.—

"(A) IN GENERAL.—For purposes of paragraph (2)(F), a change shall be deemed to benefit the consumer if the change is unequivocally beneficial to the borrower and the change is beneficial through the entire term of the agreement.

"(B) BOARD CATEGORIZATION.—The Board may, by regulation, determine categories of changes that benefit the consumer.

"(d) TERMS CHANGED AFTER APPLICATION.—If any term or condition described in section 127A(a) which is disclosed to a consumer in connection with an application to open an account under an open end consumer credit plan described in such section (other than a variable feature of the plan) changes before the account is opened, and if, as a result of such change, the consumer elects not to enter into the plan agreement, the creditor shall refund all fees paid by the consumer in connection with such application.

Consumers
Union
Publisher of Consumer Reports

The Honorable William Proxmire
Chairman
Senate Banking Committee
Washington, DC 20510

Dear Chairman Proxmire:

We appreciate the invitation you gave us to testify on Title IV of the House omnibus banking bill. Although we had originally intended to accept that invitation, it now appears impossible due to personal and family illness. We regret any inconvenience to you, other members, or your staff.

Briefly, we strongly support two provisions in the bill that have already passed the House through separate legislation -- those dealing with home equity loans and truth-in-savings. Before we see the dollar value of outstanding home equity loans double again, as they did between 1986 and 1987, Congress must put an end to some of the abusive practices under which these loans are being made.

We also believe that Congress must protect low-income consumers from some of the inevitable hardships they will face as banks move into the securities market. The House provisions requiring lifeline checking accounts, government check cashing, and improved CRA scrutiny will help ensure that all responsible consumers will have a safe place to put their money and a place to turn for basic credit needs.

For the record, I request that you include this letter into the hearing record. We look forward to working with you and your staff on all these important issues during the coming weeks.

Yours truly,

Michelle Meier
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Counsel for Government Affairs

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Ralph S. Swoboda
President
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September 19, 1988

The Honorable William Proxmire
Chairman
Committee on Banking, Housing and
Urban Affairs
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As President of the Credit Union National Association (CUNA), the trade association that represents virtually all of the nation's state- and federally chartered credit unions and their 58 million members, I am pleased to comment on the consumer protection provisions in Title IV of H.R. 5094, the Depository Institutions Act of 1988. I request that these comments be included in the Committee's hearing record of September 8, 1988.

The credit union movement (CUNA) has long supported legislative efforts to improve the manner in which financial services are provided to American consumers and to curb abuses which arise from time to time in the financial community. We continue to do so. In recent years, however, we have come to realize that unless most of these legislative measures are specifically modified, they will inexorably work to erode the unique nature of credit unions. Therefore, CUNA has worked to oppose standardized across the board proposals unless changes are developed which simultaneously meet the goals of the authors of the legislation and permit credit unions the flexibility of operating in their traditional fashion. We are most pleased that the Senate and House Banking Committees have worked with CUNA in accomplishing these goals.

Credit unions were created as an alternative to the traditional banking system to provide affordable financial services to working Americans. Consumers who were excluded from the commercial banking system because of limited financial resources banded together to form these democratically controlled financial cooperatives. That financial alternative, the credit union movement, has grown into a $190 billion network providing consumer credit for more than 58 million Americans. Not only has the movement become immensely successful, but it has done so while retaining the original credit union principles. In other words, the credit union structure has not been changed. Credit unions are still non-profit *"(e) Additional Requirements Relating to Refunds and Imposition of Nonrefundable Fees.—*

"(1) In general.—No nonrefundable fee may be imposed by a creditor or any other person in connection with any application by a consumer to establish an account under any open end consumer credit plan which provides for extensions of credit which are secured by a consumer's principal dwelling before the end of the 3-day period beginning on the date such consumer receives the disclosure required under section 127A(a) and the pamphlet required under section 127A(e) with respect to such application.

"(2) Constructive receipt.—For purposes of determining when a nonrefundable fee may be imposed in accordance with this subsection if the disclosures and pamphlet referred to in paragraph (1) are mailed to the consumer, the date of the receipt of the disclosures by such consumer shall be deemed to be 3 business days after the date of mailing by the creditor.".

SEC. 464. CONSUMER EDUCATION.

The Board of Governors of the Federal Reserve System shall develop and prepare a pamphlet for distribution to consumers which contains—

(1) a general description of open end consumer credit plans secured by the consumer's principal dwell-

ing and the terms and conditions under which such loans are generally extended; and

(2) a discussion of the potential advantages and disadvantages of such plans, including how to compare among home equity plans and between home equity and closed end credit plans.

SEC. 465. CLERICAL AMENDMENTS.

(a) Chapter 2.—The table of sections for chapter 2 of the Truth in Lending Act is amended—

(1) by inserting after the item relating to section 127 the following new item:

"127A. Disclosure requirements for open end consumer credit plans secured by the consumer's principal dwelling."; and

(2) by inserting after the item relating to section 136 the following new item:

"137. Home equity plans.".

(b) Chapter 3.—The table of sections for chapter 3 of the Truth in Lending Act is amended by inserting after the item relating to section 146 the following new item:

"147. Advertising of open end consumer credit plans secured by the consumer's principal dwelling.".

SEC. 466. ABILITY TO COMPARE PLANS.

(a) Study Required.—Before the end of the 6-month period beginning on the date of the enactment of this subtitle, the Board of Governors of the Federal Reserve System shall conduct a study to determine whether the use of the same term, such as annual percentage rate, to describe the cost to

the consumer for extensions of credit under all forms of consumer credit plans may unduly mislead consumers with respect to the comparability of the various forms of such extensions of credit.

(b) REPORT REQUIRED.—At the conclusion of the study required under subsection (a), the Board of Governors of the Federal Reserve System shall submit a report to the Congress containing the Board's findings and conclusions in connection with such study and, if applicable, such recommendations for legislation or administrative action as the Board may determine to be appropriate, including, if appropriate, a new term to replace "annual percentage rate" or "corresponding nominal percentage rate".

SEC. 467. REGULATIONS AND EFFECTIVE DATE.

(a) REGULATIONS.—Before the end of the 60-day period beginning on the date of the enactment of this subtitle, the Board of Governors of the Federal Reserve System shall prescribe such regulations as may be necessary to carry out the purposes of the amendments made by this subtitle.

(b) EFFECTIVE DATE.—The amendments made by this subtitle, and the regulations prescribed pursuant to subsection (a) with respect to such amendments, shall apply to—

(1) any agreement to open an account under an open end consumer credit plan under which extensions of credit are secured by a consumer's principal dwell-

ing which is entered into after the end of the 5-month period beginning on the date on which the regulations prescribed under subsection (a) become final; and

(2) any application to open such an account which is distributed by, or received by a creditor, after the end of such 5-month period.

(c) VOLUNTARY COMPLIANCE.—Notwithstanding subsection (b), any creditor may comply with the amendments made by this subtitle, in accordance with the regulations prescribed by the Board, before the effective date established under such subsection.

Subtitle G—Expedited Funds Availability Amendments

SEC. 471. TREATMENT OF CERTAIN CREDIT UNIONS AS LOCAL ORIGINATING DEPOSITORY INSTITUTIONS.

(a) IN GENERAL.—Section 607 of the Expedited Funds Availability Act (12 U.S.C. 4006) is amended by adding at the end thereof the following new subsection:

"(f) TREATMENT OF CERTAIN CREDIT UNIONS AS LOCAL ORIGINATING DEPOSITORY INSTITUTIONS.—

"(1) IN GENERAL.—If, in connection with a deposit of a check in an account at a receiving depository institution, the originating depository institution with respect to such check is a depository institution which is—

"(A) described in clause (iv) of section 19(b)(1)(A) of the Federal Reserve Act; and

"(B) located in the same check processing region as the receiving depository institution,

the fact that such check is payable through a depository institution located outside such check processing region for collection purposes (pursuant to an agreement entered into by such originating depository institution) shall not affect the designation of such originating depository institution as a local originating depository institution for purposes of this title.

"(2) TERMINATION.—Paragraph (1) shall cease to apply as of the end of the 3-year period beginning on the date of the enactment of this subsection.".

(b) REPORT REQUIRED.—Before the end of the 18-month period beginning on the date of enactment of this Act, the Board of Governors of the Federal Reserve System (hereinafter in this section referred to as the "Board") shall submit a report to both Houses of the Congress on the incidence that checks drawn on originating depository institutions described in clause (iv) of section 19(b)(1)(A) of the Federal Reserve Act which are payable through depository institutions, for collection purposes, which are located outside the check processing regions in which such originating depository institutions are located result in losses to the receiving

depository institutions due to check fraud as compared to all other depository institutions.

(c) ***Additional Subjects Required to Be Included in Report.****—The report required under subsection (a) shall also include—*

(1) a report on all actions taken by the Board pursuant to section 609(b) of the Expedited Funds Availability Act;

(2) a complete description of the check clearing and truncation services provided by the Federal Reserve banks to depository institutions, the fees imposed for the provision of such services, and the direct and indirect costs incurred by such banks in providing such services;

(3) a complete description of the extent to which the Board is in compliance with the requirement contained in section 11A of the Federal Reserve Act to assess fees;

(4) a complete description of the impact the provision of services referred to in paragraph (2) by the Federal Reserve banks has had on other entities which compete with such banks in providing such services; and

(5) a list of the depository institutions to which the Federal Reserve banks provide any service referred

to in paragraph (2) and the entities which provided any such service to such depository institutions before the Federal Reserve banks provided such service to such institutions.

(d) DEFINITIONS.—For purposes of this section, the terms "check", "check processing region", "depository institution", "originating depository institution", and "receiving depository institutions" have the meanings given to such terms in section 602 of the Expedited Funds Availability Act.

SEC. 472. AMENDMENTS TO THE EXPEDITED FUNDS AVAILABILITY ACT.

(a) SECTION 604 SAFEGUARD EXCEPTIONS.—Section 604 of the Expedited Funds Availability Act (12 U.S.C. 4003) is amended—

(1) in subsection (b), by inserting "(a)(2)," after "under subsection";

(2) in subsection (c)(1), by striking out "(a)(2)(F)," and inserting in lieu thereof "(a)(2),"; and

(3) in subsection (d), by inserting "(a)(2)," after "subsections".

(b) NEXT DAY AVAILABILITY FOR CERTAIN DEPOSITS.—

(1) U.S. TREASURY CHECKS.—Section 603(a)(2)(A) of the Expedited Funds Availability Act (12 U.S.C. 4002(a)(2)(A)) is amended—

(A) by striking out "and" at the end of clause (i);

(B) by inserting "and" after the semicolon at the end of clause (ii); and

(C) by adding at the end thereof the following new clause:

"(iii) is deposited in a receiving depository institution which is staffed by individuals employed by such institution;".

(2) CHECKS DRAWN ON THE SAME DEPOSITORY INSTITUTION.—Section 603(a)(2)(E) of the Expedited Funds Availability Act (12 U.S.C. 4002(a)(2)(E)) is amended to read as follows:

"(E) a check which—

"(i) is deposited in a branch of a depository institution which is staffed by individuals employed by such institution; and

"(ii) is drawn on the same or another branch of the receiving depository institution if both such branches are located in the same State or the same check processing region.".

(c) Section 604 Notice of Exceptions.—Section 604(f)(2)(C) of the Expedited Funds Availability Act (12 U.S.C. 4003(f)(2)(C)) is amended by striking out "(d)" and inserting in lieu thereof "(b), (d),".

(d) Section 611 Civil Liability.—The first sentence of section 611(f) of the Expedited Funds Availability Act (12 U.S.C. 4010(f)) is amended by inserting "or other entities participating in the payments system, including States and political subdivisions of States on which checks are drawn," after "depository institutions".

(e) Delay in Applicability of Civil Liability Provisions to Certain Violations.—Section 613 of the Expedited Funds Availability Act (12 U.S.C. 4001 note) is amended by adding at the end thereof the following new subsection:

"(c) Delayed Applicability of Certain Provisions.—A depository institution may not be held liable under subsection (a) or (b) of section 611 for failure to comply with any requirement imposed under sections 604(f) and 605 during the period beginning on September 1, 1988, and ending on December 31, 1988.".

Subtitle H—Access to Credit

SEC. 481. AMENDMENT TO THE EQUAL CREDIT OPPORTUNITY ACT.

Subsection (a) of section 703 of the Equal Credit Opportunity Act is amended to read as follows:

"(a)(1) Subject to the provisions of paragraph (2), the Board shall prescribe regulations to carry out the purposes of this title. These regulations may contain but are not limited to such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate or substantiate compliance therewith.

"(2) In no event shall any regulation promulgated pursuant to paragraph (1) of this subsection exempt from the provisions of this title any class of transactions that are primarily for personal, family, or household purposes, or business or commercial loans made available by a financial institution, except that a particular type or class of such transactions may be exempted if the Board determines, after a hearing conducted on the record pursuant to chapter 5 of title 5, United States Code, that the application of this title or of any provision of this title of such transaction would not contribute substantially to effecting the purposes of this title.

"(3) An exemption granted pursuant to paragraph (2) shall be for no longer than five years and shall be extended only if the Board makes a subsequent determination, in the manner described by such paragraph, that such exemption remains appropriate.

"(4) The Board shall require entities making business or commercial loans subject to the requirements of this subsection to maintain such records or other data relating to all such loans as may be necessary to evidence compliance with this subsection or enforce any action pursuant to the authority of this Act. In no event shall such records or data be maintained for a period of less than one year. The Board shall promulgate regulations to implement this paragraph in the manner prescribed by chapter 5 of title 5, United States Code.

"(5) The Board shall provide in regulations promulgated pursuant to this subsection that an applicant who has been denied a business or commercial loan subject to the requirements of this subsection shall be provided a written notice of such applicant's right to receive a written statement of the reasons for the denial of such loan.".

cooperatives, with no capital stock, which are mutually owned, directed by volunteers, democratically controlled and motivated by service to members rather than profits for shareholders.

Some consumer protection laws have recognized the credit union difference. Mr. Chairman, as you know, the 1977 Community Reinvestment Act, which you sponsored to "establish a system of regulatory incentives to encourage banks and savings institutions to more effectively meet the credit needs of the localities they are chartered to serve," does not include credit unions. The consumer protection provisions in Subtitle A of Title IV in the House Banking Committee bill contain more rigorous criteria for evaluating the performance of depository institutions in meeting community needs, and once again credit unions are not included.

Community reinvestment requirements are not meaningful for credit unions because as cooperatives they extend credit only to their membership. The funds placed in credit unions by members are consistently used for the benefit of those members. Including credit unions in community reinvestment would not affect the availability of credit to consumers; moreover, compliance costs could make products and services less affordable for credit union members.

Likewise, Section 411 of the House Committee bill provides for the establishment of consumer divisions within financial institution regulatory agencies to determine the extent to which financial institutions are in compliance with laws and regulations relating to consumer protection, including community reinvestment laws. Section 411 does not require a consumer division to be established within the National Credit Union Administration.

CUNA appreciates these acknowledgements of credit unions' performance in meeting consumer needs.

Other provisions in Title IV which do effect credit unions also address their unique structure. For instance:

Basic Financial Services Account/Government Check Cashing:

Section 422 of H.R. 5094 would require financial institutions to offer a two-tier basic banking account to provide low-cost transaction and government check cashing services for low- and moderate-income families.

Approximately two-thirds of all credit unions do not offer transaction (share draft) accounts. Practically all of those that do offer these accounts are voluntarily providing the services required by H.R. 5094. "Lifeline banking" was a credit union practice long before the term was even invented. A similar situation exists for credit union check cashing practices. More than 65% of all credit unions have no cash operations. However, the vast majority of those that do keep cash on the premises voluntarily cash government checks free of charge for members.

H.R. 5094 responds to the uniqueness of credit union operations and effectively preserves the right of elected credit union officials to determine the products and services available to members. As reported, the provisions of Title IV would require only depository institutions that currently offer transaction accounts to maintain a basic transaction service and only those credit unions which, in the ordinary course of business, cash checks, to do so free of charge for members.

CUNA supports and appreciates these modifications.

Truth in Savings:

Section 441 of H.R. 5094 contains virtually the same truth-in-savings requirements as those in Title VI of the "Financial Modernization Act of 1988," S. 1886. Both bills contain provisions that would permit the National Credit Union Administration (NCUA) to promulgate regulations for credit unions. The language in both bills would give the NCUA the necessary flexibility to accommodate the unique structure of credit union accounts.

CUNA supports the truth-in-savings provisions for credit unions in both the House and Senate bills.

Home Equity Disclosure:

With respect to the Home Equity Loan Consumer Protection provisions as contained in the House bill, we would strongly request that the credit union accommodations incorporated in the Senate-passed version prevail. Specifically we refer to Title VII of S. 1886 Sec. (d)(2)(B) -- Special Rule For Credit Unions. This provision would permit credit unions so desiring to use their individual cost of funds as the index required by the legislation so long as such cost of funds does not exceed the prime rate as published by the Federal Reserve. Such cost of funds must be published and distributed by those credit unions to their members on a quarterly basis.

There are many reasons for using cost of funds, such as less volatility and generally lower rates for the consumer, but our prime contention flows from a recognition of a basic credit union difference. Member owned credit unions are simply not led to a practice of charging unnecessarily high rates to their members nor deliberately misleading them as to the nature of the rate. We have not received reports of credit union abuse with respect to these home equity loans and we feel that the cost of funds method must be preserved as an option.

In conclusion, Mr. Chairman, we wish to thank you for your efforts on behalf of credit unions in this legislative proposal and for your constant assistance and friendship over the many years you have so illustriously served in the U.S. Senate. We in the credit union movement will certainly miss your leadership and counsel and wish you the very best in the years ahead.

Sincerely,

Ralph Swoboda
President

NAFCU

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September 6, 1988

The Honorable William Proxmire
Chairman
Committee on Banking, Housing, and
  Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing to you on behalf of the National Association of Federal Credit Unions, the only national organization exclusively representing the interests of credit unions chartered by the federal government, regarding the consumer protection provisions contained in H.R. 5094, the Depository Institutions Act of 1988. I understand that the Committee will hold hearings on September 8 and 9 on the consumer title of this legislation, which was recently reported by the House Banking Committee. I respectfully request that this letter be included in the Committee's official hearing record.

From their very genesis, credit unions have been in essence consumer organizations. Credit unions typically arose out of the frustration of individuals who could not find credit opportunities and a favorable return on savings at commercial financial institutions. Instead, they pooled their resources to meet the borrowing and savings needs of their communities. Not only were credit unions established to provide the essential financial services to their members that commercial institutions could not or would not provide, but they were structured as democratically-controlled, volunteer-directed cooperatives to guarantee that the credit union's members could determine for themselves what those services would be.

The credit union community has remained true to the founding ideal of "people helping people" to this day. While the minimal financial services needed to exist in modern society are far more extensive than they once were, credit unions continue to serve their members effectively and inexpensively. Thus, it was not surprising that a recent Consumer Reports survey on checking accounts characterized the overwhelming majority of credit union share draft accounts as "efficient," although only one out of three checking accounts offered by banks or savings and loans could be characterized as such.

It is important to note that Congress granted credit unions the authority to offer transaction accounts less than ten years ago. Since then, approximately 37% of our nation's federal credit unions (3100 credit unions) have taken advantage of this authority to provide this service to their members. However, two out of three federal credit unions do not offer share draft accounts today because either the limited size of the credit union does not allow for the prerequisite manpower and technology, or the members of that credit union decided they did not want their credit union to offer that service. Similarly, a significant proportion of federal credit unions do not have cash operations.

H.R. 5094 recognizes these important characteristics of credit unions. Section 422 of this legislation provides for the establishment of a basic financial services account to meet the needs of low and moderate income families. The account would have two separate services: a basic transaction service which allows up to ten withdrawals a month, and a government check cashing service. Providing these services is not objectionable to the credit union community. To the contrary, these are precisely the type of consumer-oriented services that credit unions are expected to provide, and most which have the capacity are already doing so. In the case of basic transaction services, the data cited earlier indicates that the vast majority of credit unions which offer share draft accounts are currently meeting the criteria contained in H.R. 5094.

However, there are a significant number of credit unions which simply lack the wherewithal to offer share draft accounts or do not operate on a cash basis. Many of these credit unions, if forced to offer a basic transaction service account, would be either confronted with huge start-up costs which would severely restrict the established services which the credit union's members have themselves selected or be forced to close their doors.

The legislation as reported by the House Banking Committee responds appropriately to these credit union concerns. Section 422(d)(4) would require only depository institutions that maintain transaction accounts in the ordinary course of business to offer the basic transaction service, thereby excluding credit unions which do not offer share-draft accounts. Likewise Section 422(h) imposes the government check cashing service only upon credit unions which cash checks in the ordinary course of business, thereby accommodating those credit unions which do not operate with cash on hand.

Furthermore, both provisions respect credit unions' common bond requirement. By law, federal credit unions are only allowed to serve individuals who fall within a defined field of membership (12 U.S.C. 1759). H.R. 5094 accords full recognition to this legal restriction. Section 422(d)(1) requires that credit unions offer the basic financial services account to members only; likewise, section 422(h) restricts government check cashing services to credit union members.

An area of concern does arise, however, under the home equity loan requirements embodied in Subtitle F of Title IV. In a letter dated November 18, 1987 to the Chairman of the Senate Banking Subcommittee on Consumer Affairs, Sen. Christopher J. Dodd, NAFCU expressed its support for legislative efforts to provide consumers with more complete and timely disclosure of key rates, terms, and conditions associated with home equity loans. As member-owned, not-for-profit, and democratically-controlled financial cooperatives, credit unions take pride in the standard of disclosure prevalent in our lending practices. Indeed, the credit union-community believes that our full disclosure doctrine could well serve as a model to be followed by other financial institutions.

For these reasons, NAFCU supports the principles embodied in "Title VII -- Home Equity Loans" of the Proxmire Financial Modernization Act (S. 1886) as passed by the Senate on March 30, 1988. Similarly, we are supportive of the House legislation on this point -- H.R. 3011 and Subtitle F of Title IV of H.R. 5094 -- with one significant exception: the index requirement embodied in section 463(a) of H.R. 5094.

Many credit unions use their cost of funds as the "index" upon which variable rate home equity loans are based. It has been noted that the cost of funds method is beneficial to both a credit union's members because it provides for lower and less volatile rates of interest in most instances than a "publicly available index or rate of interest" as required by section 463(a) of H.R. 5094, and the credit union itself because it is insulated against interest rate risk.

More importantly, the use of the cost of funds method also reflects one of the key characteristics of credit unions which distinguishes them from all other financial institutions -- that a credit union is a financial cooperative through which its members pool their resources to meet the borrowing and savings needs of their community. As such, a credit union merely serves as an extension of its members. Thus, it is appropriate for credit unions to employ a variable rate index applicable to credit union borrowers which is determined by the rate of return paid to these very same individuals as credit union savers on their interest-earning accounts, subject to the cap on the maximum rate of interest imposed by section 1204 of the Competitive Equality Banking Act.

Hon. William Proxmire
September 6, 1988
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Furthermore, the primary reason for requiring a public index -- namely to protect borrowers from potential lender abuse -- is largely inapplicable to the credit union community. The members of a credit union's board of directors -- who determine the credit union's borrowing and savings policies -- are duly elected by and from the membership of the credit union at large. Loan and dividend rate decisions affecting a credit union member are made by one's neighbors, colleagues at the work place, or fellow church-goers, and include considerations well beyond those of a bank officer who is responsible to corporate shareholders alone. As a result, credit unions do not make loans, either secured by residential property or not, to members where the terms are unclear or duplicitous, or the conditions are unfair and may lead to a high incidence of default to their fellow credit union members. This is no less true in the case of home equity lines of credit, where default might lead to the dreaded consequence of a credit union member losing his or her home.

For these reasons, the Senate deemed it appropriate to provide credit unions a limited exemption to the internal index requirement contained in Title VII of S. 1886. Specifically, section 702(d)(2)(B) would permit credit unions to use its cost of funds index as the basis for a adjustable rate home equity loan provided that this index does not exceed the Federal Reserve prime rate and it is publicly available to its members. NAFCU strongly supports this provision, and requests that the Senate insist upon its language in the event of a conference with the House on this legislation.

On behalf of NAFCU, I thank you for your consideration of our views on this important legislation. We look forward to continuing to work together with you on these issues.

Sincerely,

Robert A. Hess
Chairman

U.S. Public Interest Research Group
National Association of State PIRGs

September 9, 1988

Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

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Dear Senators:

We applaud the Committee for its unwavering support of the Home Equity Loan Consumer Protection Act of 1988, the Truth In Savings and Investments Act and an anti-preemption provision which allows states to create membership-based Financial Consumers' Associations which will educate and represent consumers on financial matters. These provisions in S. 1886 represent another step forward in ensuring that consumer protection laws are revised to keep pace with the burgeoning financial marketplace.

As you contemplate the impact of the restructuring envisioned by S. 1886, we urge you to consider consumer provisions which will complement and counter-balance the effects of such changes. Specifically, federally-chartered institutions should first establish that they are meeting the credit needs of their existing client base and the communities in which they operate. Compliance with the spirit and letter of the Community Reinvestment Act (CRA), provision of basic banking services to moderate and low income persons, government check cashing for recipients of government benefits and compensation, and advance notification of branch closures are key consumer provisions that should be addressed.

Title IV of H.R. 5094 is a carefully designed set of provisions which address unmet banking needs of consumers throughout the country. The provisions are aimed at consumer services that the majority of lending institutions have failed to provide on their own.

We applaud those institutions such as California First Bank with 135 branches in California which offers government check cashing, and Meritor Savings Bank in Washington D.C. and Virginia which offers a no cost basic checking account. Institutions such as Fidelcor in Philadelphia which have made commitments to build strong CRA records are to be commended. However, it is clear that voluntary provision of services to all sectors of the consumer community is the exception to the rule.

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The consumer protection provisions of H.R. 5094 were meticulously drafted in an attempt to resolve issues of cost, workability and ease of implementation. Revisions to refine the logistical issues of the title are certainly appropriate for continuing discussion. However, tampering with the substance of the provisions would represent bowing to an industry which has failed to self-regulate to meet the needs of large segments of consumers.

We urge the Committee to continue to focus on the issue of consumer protection and service, and the balanced approaches we are proposing to achieve these goals. Industry attempts to limit the scope of the debate to their philosophical opposition to the provisions should be discouraged so that we can focus on the substance of the issues at hand.

We commend the Chairman and the Committee members for taking the initiative to hold hearings on this matter.

Sincerely,

Leslie S Gainer

Leslie Gainer
Consumer Lobbyist